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  For further details, please contact Anja Gruhn
  (gruhn@housingfinance.org)

International Union for Housing Finance
Rue Jacques de Lalaing 28, B 1040-Brussels - Belgium
Tel: +32 2 231 03 71
Fax: +32 2 230 82 45
www.housingfinance.org
Secretary General: Hartwig Hamm

Editor's introduction
No room at the inn?

↳ **By Andrew Heywood**

The public provision or promotion of new housing is usually motivated in part by a desire to foster economic growth. As *Homes for London: the draft London housing strategy 2013*, which was launched in November points out:

"Every new home built creates two jobs for at least a year, and house builders are significant providers of apprenticeships. Every £1 of investment in construction is estimated to generate a total of £2.84 in total GDP. "

Thus far few would disagree with the sentiment; governments have long used investment in housing to generate accelerated economic growth and such investment has frequently been used to smooth out the impacts of the economic cycle. Peter Williams in an article in this journal draws attention to just these effects[1]. Economic growth is a key factor and within England London has an economic growth rate almost twice that of the country as a whole.

The position can become more contentious in housing policy terms where economic factors influence who should be housed. The draft London strategy states:

"In 2012 the Mayor launched his Housing Covenant. The premise is simple: those who contribute through hard work to London's success should expect a reasonable offer in return."

The strategy identifies "professional, senior managers or associated professional and technical jobs" as key in this respect and states that "failure to provide homes for this group could have a disproportionate negative impact on London's economy as many move out of the capital in search of adequate housing." London is not unique in focussing on groups with a key economic significance. In a fascinating article in this issue Ying Chang and Jie Chen examine housing policy in Shanghai, a city with over twice the population of London. Amongst a range of policies they point to the Public Rental Housing Programme and its role in housing the "talented class" of younger, more educated and higher skilled workers[2]. In his round up of events in South America Ronald Sanchez Castro refers to programmes in Chile for directing subsidies to the "emerging middle class".[3]

Although London will also introduce a new more heavily subsidised tier of Affordable Rent housing to cater for those on the lowest incomes the above example from the UK capital does serve to remind us that at a time when public resources are limited there can be a real tension between directly assisting those most in need and promoting economic growth that should, ultimately be for the benefit of all. Such tensions are not easily resolved by those with responsibility for housing policy since they touch not just on our aspirations for prosperity but on fundamental issues of morality. At this time of the year the Christmas story of the birth of Jesus whose mother Mary "laid him in a manger; because there was no room for them in the inn" provides a poignant reminder that for humanity questions about aspiration and assistance and the degree to which we should subordinate direct offers of help to the needy in order to indirectly promote greater economic well-being are never easy to resolve[4].

In addition to the usual updates of news and events from the global regions we have five significant full-length articles in this issue of HFI.

Housing privatisation has been a feature of housing policy in Western Europe and the so-called transition economies for over two decades. In their article *Implications of housing privatisation in Europe*, Wolfgang Amann and Katerina Bezgachina offer an important analysis of the privatisation of public housing stock and set out some of the positive and negative lessons that should be learned by policy makers and politicians.

The article by Peter Williams, *Housing finance and the housing market; lessons from the UK?* (referred to above) derives from a presentation at the highly successful IUHF congress in Vienna in June 2013. The article focuses particularly on the period since 2007 and the banking crisis. Professor Williams highlights the impact of the crisis and the UK Government response together with the implications for the wider housing finance community. He also provides a valuable overview of trends in the UK housing market including the decline in home ownership and social renting together with the rise of the private rented sector.

Ying Chang and Jie Chen offer a valuable analysis of public housing in Shanghai, a city of over 23 million inhabitants. Their article covers not just the Public Rental Housing Programme but traces the development of a range of programmes that aim to tackle the formidable housing issues thrown up by this burgeoning urban environment and by the need to promote economic growth from a neo-liberal political perspective.

Egypt has not so far been well-represented in the pages of HFI. We are therefore pleased to include an article by Mona Mostafa, *Mortgage practice in Egypt*. Ms Mostafa focuses on the relatively underdeveloped state of the Egyptian mortgage market, which currently amounts to less than 1% of GDP. Using a series of personal interviews with experts and market players, she offers their insights into the issues facing those who wish to expand the market together with a number of significant recommendations for improvement.

Our final article by Vibha Batra and Kalpesh Gada examines the role that mortgage guarantees (otherwise known as mortgage insurance) could play in the Indian mortgage market by using risk transfer from the lender to the Mortgage Guarantee Company to improve a number of indicators including levels of regulatory capital required and profitability.

Having briefly described this excellent issue of HFI it only remains for me to offer seasonal greetings to all our readers.

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[1] Peter Williams: Housing finance and the housing market; lessons from the UK?

[2] Ying Chang & Jie Chen: Public housing in Shanghai: a tool with multiple purposes.

[3] Ronald Sanchez Castro: Housing finance in South America 2013

[4] St. Luke Chapter 2 verse 7, The Bible, Authorised Version.

Contributors' biographies

Associate Prof. Dr. Wolfgang Amann; as director of IIBW, the Institute of Real Estate, Construction and Housing Ltd., Vienna/Austria, Wolfgang Amann has executed some 300 research and consulting projects on housing finance, housing policy and housing legislation in Austria, the EU and many CEE and transition countries. He is a consultant to the UN and World Bank and teaches real estate economics on several graduate programmes in Austria. Email: amann@iibw.at.

Habib Attia is Donor Coordinator at the Making Finance Work for Africa [MFW4A] Partnership. Prior to his position at MFW4A, he spent more than 10 years in financial sector development in Africa and held successively different positions within Central Bank of Algeria, AFD, CGAP and MicroCred. A PhD candidate in Financial Inclusion Strategy in the MENA region, Habib Attia holds a Master's degree in Economics from CERDI, University of Auvergne, France; and graduated in advanced banking studies in Algeria. Email: h.attia@afdb.org.

Vibha Batra is Co-Head Financial Sector Ratings at the Indian Credit Rating Agency [ICRA], the Indian associate of Moody's Investors Service and is also a member of ICRA's Rating Committee. She has worked on financial sector ratings covering banks and non-bank finance companies. Email: Vibha@icraindia.com.

Katerina Bezgachina is PR and Media Manager with Habitat for Humanity Europe, Middle East and Africa in Bratislava, Slovakia. She is involved in housing related research and communication about housing problems in Europe and Central Asia. Katerina holds an MA in International Relations and European Studies from CEU and an MA in Journalism from the University of London. Prior to Habitat, she was a reporter and news editor for print and radio, covering among other things real estate in Russia and Central and Eastern Europe. Email: kbezgachina@habitat.org.

Ying Chang is Assistant Professor, Department of Urban Planning and Design, Xi'an Jiatong-Liverpool University, 111 Renai Road, Dushu Lake Higher Education Town, Suzhou Industrial Park, Jiangsu Province, PR China 215123. Email: Ying.Chang@xjtlu.edu.cn.

Jie Chen is Professor, at the School of Public Economics and Administration, Shanghai University of Finance and Economics, Shanghai, 200433, China. Email: chen.jie@mail.shufe.edu.cn.

Kalpesh Gada leads the Structured Finance Ratings team at the Indian Credit Rating Agency [ICRA], the Indian associate of Moody's Investors Service and is also a member of ICRA's Rating Committee. He has worked on securitization ratings involving various asset categories including vehicle loans, home loans, unsecured personal loans, small business loans, as well as corporate loans. Email: kalpesh@icraindia.com.

Mona Mostafa holds a Master's degree in Public Policy and Administration from the American University in Cairo, Egypt. Her research has focused on the institutional capacity and challenges of the Egyptian mortgage market. Email: monamt@gmail.com.

Alex J. Pollock is a resident fellow at the American Enterprise Institute in Washington DC, USA, a Past-President of the IUHF, and was President and CEO of the Federal Home Loan Bank of Chicago1991-2004. He can be reached at apollock@aei.org.

Zaigham M. Rizvi is Secretary General of the Asia Pacific Union for Housing Finance, email: zaigham2r@yahoo.com

Kecia Rust is the coordinator of FinMark Trust's Centre for Affordable Housing Finance in Africa, and manages the Secretariat of the African Union for Housing Finance. She is a housing policy specialist and is particularly interested in access to housing finance and the functioning of affordable property markets. Kecia holds a Masters of Management degree (1998), earned from the Graduate School of Public and Development Management, University of the Witwatersrand. She lives in Johannesburg, South Africa.

Ronald A. Sanchez Castro is Economist and Master of Finance at Federico Villarreal University in Peru. He is a researcher and consultant on finance, housing and urban development, and is Technical Secretary to the Inter-American Housing Union [UNIAPRAVI]. Email:rsanchez@uniapravi.org.

Mark Weinrich holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the manager of the Department of International Affairs at the Association of Private German Bausparkassen. He is the Head of the Department of Economic Affairs for the International Union for Housing Finance in Brussels.

Peter Williams was the Director of the University of Cambridge Centre for Housing and Planning Research at the University of Cambridge with specialist interests in the areas of housing finance, markets and policy and is now a Senior Visiting Fellow in the Department of Land Economy (from 1/1/2014). He is also Executive Director of the Intermediary Mortgage Lenders Association. He was previously Chairman of the Government's National Housing and Planning Advice Unit [NHPAU], Deputy Director General of the Council of Mortgage Lenders and Professor of Housing at the University of Wales, Cardiff. Email: consultpwilliams@btinternet.com.

Housing finance news from Africa: donors align efforts to support growth in the housing finance sector

By Habib Attia, Making Finance Work for Africa and Kecia Rust, Secretariat, African Union for Housing Finance

The growth and development of Africa's housing finance sector has for some time received the attention of international development finance institutions and donors, working alongside either the private sector or government in specific countries or regions, to support specific, targeted initiatives. For example, in recent months, the news has highlighted developments in Nigeria, Tanzania and Egypt where the World Bank has committed loan facilities to support the housing finance sector. The French Development Agency [Agence Francaise de Development, AfD] has signed loan agreements with Shelter Afrique to support housing microfinance, and with Nedbank, one of the largest banks in South Africa, to promote consumer education on housing. Moreover, AfD, in partnership with Lafarge, has also extended a long term line of credit to LAPO (Lift Above Poverty Organization), a Nigerian micro-finance institution, to support the development of new housing products. The European Investment Bank [EIB] is also working in South Africa, providing a loan facility to support the funding of affordable and social housing.

In an effort to begin to keep track of these initiatives, Making Finance Work for Africa [MFW4A], a G8 initiative established to support the development of African financial sectors, has developed a Financial Sector Development donor projects database. The database, available on the MFW4A website (www.mfw4a.org), shows a total of more than 1,500 projects, of which a total of 57 donor and development partner initiatives are somehow involved in housing finance in Africa. The majority of interventions are loans and just under half of the initiatives focus on the development of financial products; 36 percent on policy and regulation. About a fifth of the initiatives provide advisory services; 12 percent provide supply-side support and 12 percent are directed at research and knowledge.

Given the breadth of this activity. MFW4A has launched a Housing Finance Donor Working Group [HF-DWG], to coordinate activities between donors. The HF-DWG has four broad objectives:

- Provide a platform for donors to exchange information on innovative housing finance products and business models;
- Promote the broad use of long-term financial services as a key solution for the housing finance gap in Africa;
- Encourage joint donor interventions on housing finance issues in Africa; and
- Create an enabling environment for raising capital towards the housing finance sector in Africa.

Members of the HF-DWG include MFW4A, AfD, AfDB, Developpement international Desjardins [DiD], EIB, FinMark Trust, the FIRST initiative, the German development bank GIZ, the International Finance Corporation [IFC], the MasterCard Foundation, UN Habitat, and the World Bank. The group presented their goals and programme of work at the recent AUHF Annual Conference, held in Mauritius in September 2013.

During the panel discussion, Dr Issa Faye of the AfDB, presented on that institution's plans to undertake research into the state of Africa's housing market. The research initiative, which is expected to begin at the end of 2013, will commission a series of thematic papers which will then be presented to five regional workshops, across Africa. The core output of the study will be a comprehensive analysis of Africa's housing market at the continental level. It is expected to also propose concrete policy recommendations to foster private sector and DFI involvement in affordable and quality housing on the continent. Mrs. Isadora Bigourdan reported that AFD's main focus in the housing sector was on supporting finance to the benefit of the middle to low income households, and to promote green and sustainable housing initiatives. AFD has also developed a strong partnership with Shelter Afrique, supporting their social housing programme with soft loans and a grant directed at financial innovation. DiD's Francois St Pierre explained that their focus was primarily on the development of appropriate housing microfinance approaches that would be suitable for addressing the breadth of the need in most African countries. Finally, IFC's Britt Gwinner reported that with 19 percent of IFC's $18,3 billion in commitments going to sub-Saharan Africa, the region was a priority for IFC, second only to Latin America & the Caribbean. IFC provides investment services, advisory services and the investment of third party capital through an asset management company. Britt Gwinner highlighted the opportunity that the donors and DFIs were seeking to maximise with their public and private sector counterparts. With a strong demand for housing finance across Africa, public authorities in many countries have made reforms in recent years that make investment in the sector much more attractive. However, there was insufficient residential developer and builder capacity. Banks could only make affordable mortgages if the formal sector was building affordable houses. Unfortunately, explicit attention to what would constitute an enabling environment for business in the housing construction and finance sectors was still weak – donor and DFI advisory services were therefore targeting these issues. Lastly, macro-economic factors also begged for attention: interest rates specifically remained far too high.

By coming together in a HF-DWG, the donor and development partner members of the HF-DWG hope that they might realise the opportunity set by the demand and overcome the challenges that they were each facing individually.

The MFW4A will coordinate the group's objectives in a way that supports the broader growth of the housing finance sector across the continent. The DWG has agreed a work plan with the following activities, and driven jointly by HF-DWG members' organisations:

- Knowledge management and dissemination: advocating for better and more unified data on housing finance, and data sharing among WG members;
- Projects' support: using lessons learned from other parts of the world and pilot projects, to identify one or several models that could be applied for the provision of housing finance in Africa; and
- Promote an enabling environment for housing finance in Africa, working together and engaging with relevant African stakeholders in the sector to support policies, expand access to finance for housing, increase awareness of the importance of housing finance and improve investors' confidence on housing investments.

More details on MFW4A can be found on www.mfw4a.org. The various presentations made by the DWG members at the AUHF Conference are available on the AUHF website: http://www.auhf.co.za/conference/mobilising-capital-for-housing-finance/

Asia-Pacific Union for Housing Finance: News Update Q3-2013

↳ By Zaigham M. Rizvi, Secretary General APUHF

The Government of Afghanistan has approved the formation of a Mortgage Department. This unit of the Central Bank of Afghanistan [DAB] would exclusively be dedicated to the development of mortgage policies, guidelines, products and various other functions. It is expected to play a proactive and pivotal role in the promotion of housing and housing finance in the country. The Central Bank is currently in negotiations with the Asian Development Bank [ADB] to seek technical and financial assistance for the advancement of housing and housing finance in the country. The DAB is also pursuing Islamic finance including Sharia-compliant housing finance. The DAB already has an Islamic Finance Department, and is now selecting a Sharia Advisory Board as well. The country is currently at an advanced stage in setting up a Credit Bureau as well, which is likely to be operative by February 2014. The DAB is also currently working to have a trained work-force for property appraisal and valuation and is planning to initiate a training/certification program for the purpose. The country essentially needs property registration and transfer to be both cost and time efficient, and is exploring possible technical assistance for the purpose from the World Bank/International Finance Corporation [IFC].

In Thailand, the "Mortgage rules will be stricter next year and interest rates likely higher,….We need to find supportive measures to help customers receive mortgage approval and reduce rejection rates." , said the former president of the Government Savings Bank. Pruksa, the leading real estate institution is negotiating with local insurance companies for the facility of Mortgage Insurance and expects to apply the insurance scheme next year. The company's rejection rate is now 22-23%, the same as last year. Pruksa now helps customers obtain mortgage approvals by offering a variety of mortgage packages from 13 financial institution partners and by self-screening customer qualifications. The Quality Housing Thailand [QH] President Mr. Rutt Phanijphand has announced that QH has bumped up its down-payment rate for a condominium to 15-20% of the unit price from 10-15% in its own bid to cap mortgage rejections at 10%[1].

Bangkok's condominium market showed signs of slowing in the suburbs in the third quarter, according to a report by Colliers International Thailand. The number of new projects decreased by 10.5% from the previous quarter. The decrease was because developers were concerned about household debt in the middle-to-low-income market and focused more on the higher-income urban market and along the extensions of mass transit systems.

GH Bank Thailand is celebrating its 60th anniversary with two commemorative publications, in both the Thai and English languages. The Thai publication is based on a "60 years building foundations for happy homes," theme and the English publication is entitled "Happiness and Warmth, 60 years building foundations for Happy Homes". The English publication will provide readers with a deeper insight into how GH Bank has successfully achieved its vision and mission to provide dream homes to as many Thai people as possible. Copies can be obtained from GH Bank's Research and Information Services Department or could be downloaded from the GH Bank web-site.

Bangladesh is geographically standing in a calamity-riven area, faced with frequent calamities of river erosion and fire in boats/slums, forcing around 10% of people to lead a sub-human life. Around seventy six percent of people reside in slums and risky temporary houses. According to a recent report by the Bangladesh Statistics Bureau, only 4% of the people of Bangladesh have safe and secure homes in well constructed residential buildings. As a result, close to 96% people are suffering from the shortage of decent housing units. The Bangladesh House Building Finance Corporation [BHBFC] and National Housing Authority [NHA] regulate and promote housing on behalf of the government. Both the BHBFC and the NHA have been addressing the issue of housing in Bangladesh, more so in the low-income affordable housing segment. The BHBFC, since its inception, has disbursed 43930 million Taka to help the construction of 18 million housing units, which however is merely nominal when set against the existing backlog and incremental demand. The BHBFC has approached the government to turn BHBFC in to a specialized bank. The BHBFC has also submitted a proposal to the World Bank requesting a sum of US$120 million for a rural-based housing project.

In Pakistan the new Government of Prime Minister Nawaz Sharif has announced that it

[1] Quality Houses Public Company Limited is a Thailand-based company engaged in the residential and commercial property development businesses.

intends to build 500,000 low-cost affordable housing units during the next five years. For the purpose, wherever possible, the Government will provide developed land either at nominal or no cost so as to make the housing affordable for the low-income segments of the population. To implement the program, the Government has set up a high powered steering committee under the chairmanship of the Finance Minister, with representation from the public and private sectors. The Government is also setting up a housing production company in the public sector based on the business models of TOKI of Turkey and the National Housing Authority of Thailand.

The Prime Minister of Pakistan, Mian Muhammad Nawaz Sharif recently visited Turkey's low cost housing project TOKI, with the view of replicating the project in Pakistan. Turkish Minister for Housing Erdogan Bayraktar briefed the Prime Minister about the housing project and told him that TOKI constructs houses for low income families at affordable prices. He apprised the Prime Minister that under this project, Turkey's slum areas had been developed into beautiful residential schemes. He expressed the interest of the Turkish government in investing in Pakistan's housing sector. A delegate from the Ministry of Housing in Pakistan, who accompanied the Prime Minister in his recent visit to Thailand, had also visited the Government Housing Bank of Thailand and National Housing Authority of Thailand to study their business models for providing low-income affordable housing in the country.

A Mission of the IFC visited Pakistan during the quarter under review. The Mission held meetings with various stakeholders for the revalidation of the business plan and feasibility report of the Pakistan Mortgage Refinance Company [PMRC] which is under active consideration by the IFC.

Europe: a shifting regulatory landscape

By Mark Weinrich, Manager of the Department of International Affairs in the Association of Private German Bausparkassen

For many players in the housing finance sector the operational management of the new regulatory requirements is currently the major focus. The high frequency of regulatory projects, increasing complexity due to interdependencies between the rules and great uncertainty as to the final implementation of various initiatives involve higher operating costs, so that other issues are pushed into the background. However, regulatory requirements have an ever increasing impact on strategic issues and business alignment. In addition, the sector is characterized by continuing low interest rates, increasing competition and limited prospects for growth in saturated markets, implying a growing pressure on margins.

Housing financiers that mainly rely on retail business are particularly likely to see increasing pressure on their earnings because of the low interest rate policy. The European Central Bank cut interest rates again to a record low on November 7 and said it could take them lower still. The main refinancing rate was cut by 25 basis points to 0.25 percent. The move came days after the October inflation report indicated that inflation in the Euro-zone fell to 0.7 percent year-on-year in October. The record low lending rate has raised concerns that the ECB is running out of tools – or that the tools still available might have severe side-effects. The ECB is already contemplating imposing negative interest rates on credit institutions who deposit cash with it. What extremely low or even negative rates might mean for savers is already an issue in the US. Here, retail banks recently warned that they might need to start charging customers and companies for deposits if the US Federal Reserve cuts the interest it pays on bank reserves further. While similar comments have not been heard in Europe so far, the statement by the US banks makes clear how challenging a low interest rate environment is. In addition, regulatory restrictions and intense competition limit the possibilities for action.

It is therefore good news that an agreement between the European Parliament (EP) and Council over the way in which Member States should report how they have transposed Directives has been found. This clears the way for the several times postponed EP Plenary vote on the Mortgage Credit Directive (MCD). On December 10 the EP approved the new rules on mortgage credit lending in respect of residential property. This is good news because the compromise found on the MCD in often difficult trialogue negotiations balances the interests of consumers and the housing finance sector very well:

- The MCD generally follows a principle-based approach with minimum harmonisation of detailed rules so that the differences between national mortgage markets and their specificities are both appropriately taken into account – which in turn makes better outcomes for consumers more likely.
- Buy-to-let and part residential/ part commercial properties are rightly not within the scope of the MCD as loans for these property types require a different creditworthiness assessment than is the case for residential mortgages.
- Creditors are obliged to conduct a thorough, documented creditworthiness assessment before granting credit; i.e. they have to conduct a qualified test but they do not have the "duty to deny credit" in the case of a negative assessment as an earlier proposal suggested. The solution found is consumer-friendly and avoids legal uncertainty and litigation for the lender.
- The MCD grants consumers a general right to repay their loans early but gives Member States the discretion to decide that creditors are entitled to fair compensation for costs directly and exclusively linked to early repayment. This compromise gives Member States with a tradition of fixed-rate mortgages the possibility of avoiding negative impacts on lending business and refinancing arrangements. This is because an entitlement to compensation for costs directly linked to early repayment allows lenders the freedom to make contracts with or without indemnity, thus safeguarding product variety and lower interest rates for fixed-rate loans.

After the EP has approved the MCD, a final implementation date of early 2016 is likely and the focus shifts from the European arena to the Member States and how they will transpose and implement the Directive into national legislation. Having in mind the challenges in transposing and implementing the Consumer Credit Directive, this will not be the end of the story.

Housing "wealth" and illusion

By Alex J. Pollock

Modern fiat-currency central banks are in the money illusion business, which turns into the wealth illusion business, notably when it comes to housing and the "wealth" represented by houses.

Before 2007, central bankers in the U.S. and Europe managed to convince themselves they had created a new era, "The Great Moderation"- but what they actually presided over was the Era of Great Bubbles.

In the U.S. we had first the Great Overpaying for Tech Stocks in the 1990s, then the Great Leveraging of Real Estate in the 2000s. (Of course, the Great Leveraging of Real Estate also occurred in other countries at about the same time, and Europe in addition managed to create the Great Sovereign Debt Mistake.)

Bubbles make a great many people very happy while they last, because they think they are becoming wealthier. But this so-called "wealth" is an illusion, as they discover afterwards. Inevitably following each bubble is a price shrivel, as of course happened with U.S. house prices, which fell on average over 30%. Then many American commentators talked about how people "lost their wealth," with statements like "in the housing crisis households lost $7 trillion in wealth." But since the $7 trillion is based on the house prices of the bubble, it was never really there in the first place, so it wasn't really lost.

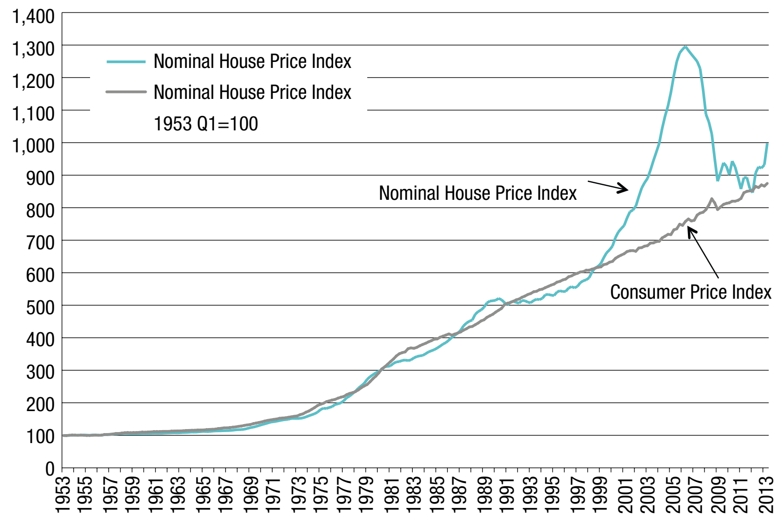
Common calculations of aggregate "wealth" take the entire stock of an asset class and multiply it by the bubble prices, on the theory that financial value is what you can sell something for. Of course, some clever or lucky individuals do succeed in selling at the bubble highs, but the aggregate bubble prices can never be realized by sale. As soon as large numbers of the owners of a bubble asset try to sell their stake in it, the bubble collapses, the evanescent "wealth" disappears, and the long-term trend reasserts itself, as Figure 1 shows.

Consider the long-term path of U.S. house prices relative to inflation. Graph 1 displays a sixty year history, 1953-2013, setting the U.S. Consumer Price Index and average American house prices both equal to 1953=100. The high correlation of general inflation and house prices over time is obvious. Equally obvious is the huge deviation from the trend relationship created by the housing bubble. Note especially how the shrivel took house prices all the way back to the long-term inflation line.

Now, however, the Federal Reserve has on its own balance sheet about $1.5 trillion of mortgage securities, making it the biggest savings and loan in the world. Under the prompting of the Fed's bond market manipulation, U.S. house prices again are moving above the inflation line. In my opinion, this is a central bank-induced asset price distortion. When the Fed ultimately stops buying bonds, and long-term interest rates rise to normal, significantly higher, levels, it will put downward pressure on these artificially-boosted house prices.

In any case, the long-term trends suggest that there is little, if any, increase in U.S. house prices on an inflation-adjusted, or real, basis which is

Figure 1 Nominal House Price Index vs. Consumer Price Index, 1953-2013



Source: MGIC

sustained over time. The trends do suggest that houses are, on average, a good hedge against the inflation that fiat-currency central banks intend to and do create.

Let us turn to another trend–that of wealth owned by U.S. households per capita, both houses and all financial assets, including pension funds. As shown in Graph 2, the tech stock and housing bubbles created big, non-sustainable departures from the long-term trend, which then disappeared.

Considered over the long term, however, netting out the bubbles, Americans have still achieved impressive increases in their ongoing wealth. The trend is for inflation-adjusted, per capita wealth in the U.S. to increase by about 2% per year. The rate of increase may seem modest, but in fact represents a miracle of the market economy. Figure 2 is the sixty year record, 1953-2013.

The Era of Great Bubbles is readily apparent, as is the subsequent regression right back to the trend. Equally apparent is the long-term trend itself, rising at 2% per year compounded on average.

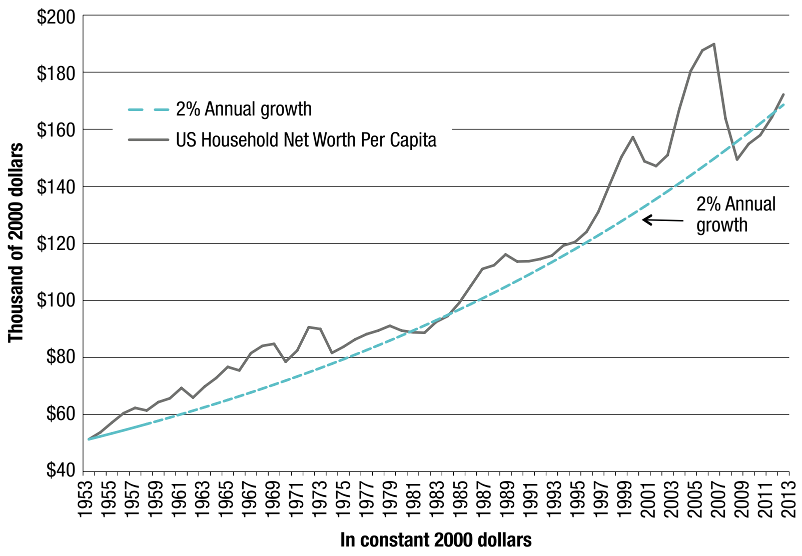
Why should it be 2%? Increasing real aggregate wealth can only result from increasing production. From 1953-2013, U.S. real GDP grew by approximately 3% a year; the U.S. population by about 1%. Thus it makes sense that on the trend, per capita wealth of the sustainable kind grows at about 3% minus 1%, or 2%, once the up and down excesses of bubbles have netted themselves out. With a 2% trend increase, in a lifetime of 83 years, Americans will on average grow five times as wealthy.

But along the way, they should avoid confusing the "wealth" of bubbles with actual wealth. They should most especially avoid incurring a lot of debt, which will prove to be quite real, against bubble asset prices, which will prove to be illusions.

Moving to a North American context, it does appear that Canada is experiencing a build-up of illusory housing wealth. Figure 3 shows the remarkable contrast between Canadian and U.S. house prices, indexed to the year 2000=100.

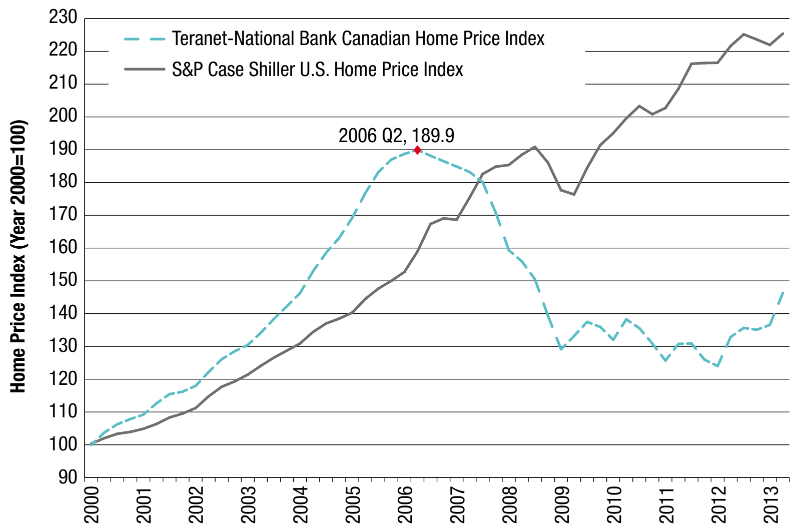
Where and how this Canadian house price run-up will end is continues to be debated. The peak of the U.S. housing price bubble was in the second quarter of 2006, more than seven years ago. With an interim correction in 2008, Canada has since then gone to levels far above the U.S. peak. Will the Canadian housing finance structures handle a shrivel, if it comes, better than the U.S. and other countries have, or not? Here is a North American study in contrast, so far, and a housing finance drama to watch.

Figure 2 Inflation-Adjusted U.S. Net Worth Per Capita, 1953-2013



Source: Board of Governors of the Federal Reserve and Bureau of Labor Statistics

Figure 3 Housing Contrast: Case-shiller U.S. Home Price Index versus Teranet-National Bank (6-City) Canadian Home Price Index, 2000-2013



Housing finance in Latin America 2013

↳ Ronald A. Sanchez Castro

In Latin America, the realities within individual countries are very different; however the countries of the region agree that to palliate the high housing deficit it is very important to secure joint participation of the public and private sectors in both the financing and construction of housing.

In Argentina, despite the particular momentum of the PROCREAR state program, which in October reached record levels of 130,000 mortgage loans, the real estate market still continues to be depressed. The PROCREAR program helped boost the construction sector, which had positive levels of growth for May. However, the real estate sector shows levels of contraction for the first quarter of 30% from the previous quarter, and in recent months fell 44.7 %, 22% and 19.4 %, in June, July and August respectively compared to the same month in the previous year. This was because the mortgage system in Argentina is stuck, due to exchange rate problems that limit sales. In May this year the stock of mortgage loans fell 2.6% compared to the same period last year. The State also launched the CEDIN (investment certificates) in mid- year, as a mechanism to "whiten" dollars and boost the real estate transactions; however it was not as successful as had been hoped.

In Brazil, there is a strong and significant the level of housing finance, driven by both the private and public sectors; the public sector through the subsidies programs. The Brazilian Association of Real Estate Credit and Savings [ABECIP] reported that during this year it has seen positive levels of funding amounting between January and September to R$ 79.3 billion. The Federal Economic Bank, reported significant amounts of funding, amounting to R $ 66 billion during the first semester. Likewise, the MIHA CASA MIHA VIDA state program has completed the delivery of 28,000 housing units, which ended up benefiting more than 120 thousand inhabitants by September 2013. The housing market also showed positive levels of home sales in Sao Paulo; in the first quarter sales grew 27.1% and in the first semester sales grew 13 %.

In Chile, this year the State has launched a program for directing housing subsidy to the emerging middle class that in September 2013 benefited 10,400 families. It also launched direct subsidies for the middle class in March and June of 15,000 and 6,000 respectively. In August, the stock of mortgage credit to the private sector amounted to $ 48.820 US million, but given the heating of the economy that has been evident since late last year the Central Bank has increased referral rates as measures to control the strong growth of this type of credit. This has been reflected in the fall of 4.35% in home sales in Santiago in the second quarter.

Colombia, since the middle of last year, has established greater State involvement in financing housing construction through the program for 100,000 units of free housing, and through extending the subsidizing of interest rates for home purchases mainly for low-income families. The State has allocated 1.3 and 1.7 billion pesos for financing the housing sector in the first and second quarters respectively. This invigorated the sector which showed growth levels in construction of 12.9 and 7.9% for the first and second quarters respectively.

In Costa Rica, there has been a strong tendency to stimulate the housing sector through providing more liquidity by eliminating the legal reserve held at the Central Bank in respect of resources for housing, increasing the credit limit given by the Mortgage Bank to ¢ 300,000, and creating a fund to finance the middle class. The aim is not only to provide access to housing for low-income families but also to encourage the private sector in housing construction, because since the first quarter activity by the construction sector showed a decrease of 4.06%.

In Ecuador, the housing finance role of the Ecuadorian Institute of Social Security [BIESS] has been highlighted, accumulating 21,696 mortgage loan contracts from January to September 2013, an increase of 16.7% compared to the previous year. Also, it has implemented policies such as increasing the maximum repayment period to 30 years for such credit, to make it more affordable to poorer families.

In the case of El Salvador, this is one of the worst years for the industry. Funding levels have decreased by more than half in June compared to the same month last year, also the housing construction sector reported in June a drop of 55%.

In the case of Panama, the country is having a good period for the housing sector. Mortgage lending growth is about 6% in each month of June, July, and August compared with the same months last year. Also it has introduced policy measures to expand credit ceilings, such as the amendment of Article 5 of Act 3 that allows for a new maximum of $ 80,000 of credits for the program of preferential interest mortgage loans.

Mexico is one of the most developed countries of the region in respect of mortgage finance, with extensive coverage by institutions specializing in housing finance. However, during this year the critical financial situation of the most important construction companies in this Sector has been highlighted (Homex, Urbi and GEO). That is why throughout this year there has been strong support from the State to boost the supply of housing through programs such as Guarantees for Construction and Fund Stimulus Vertical Housing. Another important aspect is that the incomes of the population have declined, so default on loans has increased and represented 14% of the portfolio in August. Credit has also become more expensive and during the first half rose 3.44% compared to the previous year. Still very important are the roles of the National Institute Housing Fund for Workers [INFONAVIT] and the Housing Fund of the Institute for Social Security and Services for State Workers [FOVISSSTE], which despite the collapse in their credits in the first half year (5% and 12%, respectively) have now succeeded in reversing these drops. INFONAVIT has exceeded the credit goal for 2013, more than the 545,000 individual loans projected.

In Peru, since last year there has been a rapid growth in the real state sector. Despite measures to control the rapid growth in mortgage lending, this year has seen lending still growing, although more slowly than last year. During the first half year mortgage credit grew 25.26%, compared to the same period last year. It can be seen that the provision of mortgage credit in domestic currency has become stronger that in foreign currency. The MIVIVIENDA state program and other new state programs such as Purchase Housing of Second Use have been highlighted and have boosted the construction sector so that in July it had a growth rate of 11.41%.

In Venezuela, the housing sector is led by the public sector, while private participation in the construction of homes or properties is quite depressed. So far this year various measures by the State have been implemented, such as creating an obligation on banks that 20% of their lending resources must be directed to mortgage financing. The subsidy ceiling has been increased to 350 thousand bolivars, which represents an increase of 29.6% and the interest rate was reduced to a maximum of 10.66% for mortgage loans, among others. The State also runs the Great Housing Mission program [GMV], which in September reported an advance in project implementation of only 19% of the projected level. Also the levels of growth of the construction sector for the first and second semesters have shown negative numbers 1.2% and 6%, respectively, compared to same period last year.

Implications of housing privatization for Europe

By Wolfgang Amann and Katerina Bezgachina

1. Introduction

Changes in tenure structure in Europe over the past decade show an interesting pattern. In most western European countries ownership rates are decreasing, whereas they are still rising in Central Eastern European countries, yet from a far higher starting point. Housing policy orientation on tenure structure seems to change. Increasing ownership rates used to be the mantra of housing policy in many Western countries until the 1990s and in most transition countries until recently. One of the main drivers to increase ownership rates is mass housing privatization.

In this article we analyse the present situation of tenure structure and privatization strategies all over Europe and Central Asia [ECA] and assess the benefits and disadvantages of this important housing policy tool. Finally we discuss the criteria for a rational segmentation of housing markets consisting of different tenures to allow for effective consumer choice.

Data on housing privatization in the ECA region have been scarce and rather fragmented until recently. We mainly refer to the current study of IIBW conducted for *Habitat for Humanity Housing Review on 23 countries in the Europe and Central Asia region* from 2013. This study appears to offer reliable data on this issue in a way that allows for conclusions for the entire region.

2. Housing tenure in the ECA region

2.1 Development of ownership rates

Countries of the ECA region show a big variety of ownership rates with Switzerland at one end with only 44% and Albania at the other end with reportedly 100% (2011, Figure 1). The EU average is 71%, which is quite similar to the USA or Australia. But this is different for the transition countries in the region. The Central Eastern European EU member states have an average ownership rate of 81%, South Eastern European countries of 92% and many former Soviet Union countries even higher rates with an average of 89%.

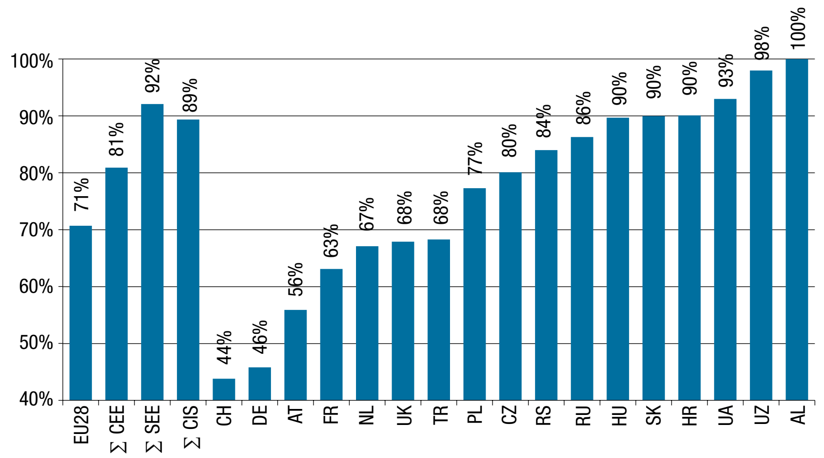
2.2 Tenure structure in the course of transition

All transition countries had strongly increasing ownership rates during the 1990s. In the 2000s dynamics decreased. In recent years some of them, such as Poland or the Czech Republic, still have significantly increasing ownership rates, whereas others, such as some Baltic states, follow a reverse trend. Between 2007 and 2011 the ownership rate in the 12 new EU member states increased by around 8 percentage points, whereas it decreased by 4 in the EU15 (EU-SILC).

Mass privatization and a lack of new rental housing construction led to a sharp decrease of rental housing in all transition countries. Today, the majority of them may be classified as *Super Homeownership States* (Stephens, 2005) with ownership rates above 90%. Rental housing has a decreasing significance in all transition countries.

However, this data hides important differences in rental tenures. For example, housing organised by co-operatives has to be classified somewhere between rental and owner-occupied housing. In

Figure 1 **Ownership rates in selected European countries, 2011**



Re.: In few cases older sources than 2011;

Country acronyms use endings of Internet country domains; regional data weighted;
Central and Eastern Europe countries (CEE): Czech Republic (CZ), Hungary (HU), Poland (PL), Slovak Republic (SK), Slovenia (SI); South Eastern Europe countries (SEE): Albania (AL), Bosnia-Herzegovina (BA), Bulgaria (BG), Croatia (HR), Macedonia (MK), Romania (RO), Serbia (RS); Commonwealth of Independent States countries (CIS): Armenia (AM), Azerbaijan (AZ), Kazakhstan (KZ), Kyrgyzstan (KG), Moldova (MD), Russia (RU), Tajikistan (TJ), Ukraine (UA), Uzbekistan (UZ)

Source: Eurostat EU-SILC, National Statistical Offices, Euroconstruct, BuildEcon, AHML, IIBW estimates (AL, UZ) some countries, tenants of co-operative housing have tenancy rights close to ownership, but in other countries such dwellings are clearly rentals. In some countries, such as Poland, both types exist side by side.

On the other hand, an informal rental market has emerged in all transition countries. Privatized owner-occupied apartments are rented out, mainly serving demand at the lower end of the market. This tenure is mostly unregulated, with hardly any tenant protection. Despite its considerable size, this tenure sector is statistically elusive, with no real data available. Hence, the documented ownership rates have to be discussed as an approximation, which makes cross-country comparison quite difficult (Amann & Lawson, 2012; Amann & Mundt, 2011; Andrews, Caldera Sánchez, Johansson, 2011).

Before transition, the significance and institutional setting of social rental housing was quite diverse. The public rental sector occupied more than 50% of the housing stock in the Soviet Union, about 28% in Central and Eastern Europe countries, and below 20% in South-Eastern European countries such as Albania, Croatia and Bulgaria. It was primarily state-owned in the CIS countries [Commonwealth of Independent States = former Soviet Union], but enterprise-owned in the countries of the former Yugoslavia. There, social ownership titles could be inherited and swapped for private ownership. Consequently, a social rental sector as such did not exist in the former Yugoslavia before transition. The homeownership sector in Bulgaria or the co-operatives in Czechoslovakia functioned quite similarly (Amann & Lawson 2012; Council of Europe 2002: 12-13; Charles Kendall / Eurasylum 2009: 7).

But in the socialist housing system, the definition of social housing was quite uncertain, as the state housing policy followed a "unitary" structure, to use the term coined by J. Kemeny (Kemeny 1995, Kemeny et al. 2001, Kemeny et al. 2005), which meant that state-subsidized housing (both in the public and in the owner-occupied sector) was open to a wide range of different income and professional groups (Amann, Hegedüs, Lux & Springler 2012).

By the 1980s, it became clear that governments were failing in their constitutional responsibility for the provision of adequate housing. Countries such as Hungary and Slovenia decided to maximize the resources of the population to address the persistent housing shortages. As a result, their share of state-owned housing decreased. Other countries, such as Russia, devoted more budget resources to housing production, thereby retaining the emphasis on state rentals (Roy 2008: 136).

Currently, the EU average share of social rental housing is 11% (EU-SILC, 2011). In the whole region though, social rental housing has quite a diverse significance, with less than 5% of the housing stock in Slovakia, Romania, Ukraine, Hungary and Armenia, but above the EU average in Slovenia, Poland, Czech Republic, Russia and Azerbaijan.

Market rental sectors differ even more from EU levels. Whereas 18% of the total housing stock in the EU is rented out under market conditions (EU-SILC), that figure is less than 2% in most SEE and CEE countries and only slightly higher in the CIS region (not considering informally rented private apartments).

There is a clear link between the rise in house prices – and the resulting affordability problems – and the demand for public and affordable housing. The constant reduction of public housing has resulted in long waiting lists, keeping a large number of people in inadequate housing conditions or affecting their expenditures in other areas, such as food, clothing and health (UN Special Rapporteur 2009: paragraph 34). Having a sufficient supply of affordable housing affects different areas of development. It is important not only for shelter purposes, but also for the formation of a cohesive, inclusive society and for a country's economic development.

3. Housing privatization in Western Europe

Public housing stocks have been privatized all over Europe. But strategies differ a lot, both concerning the beneficiaries of privatization (social landlords, commercial investors, or sitting tenants), the quality of transfer of titles, freedom of decision for landlords versus legal obligation and last but not least purchase prices. Even regarding policy targets for privatization big variations are detected. In some cases it was aimed at increasing ownership rates, mainly for ideological reasons, in others it was about raising funds for public budgets or reinvestment in social housing construction. Finally, some initiatives aimed to improve housing management with new owners. The cases of the UK and Germany demonstrate two quite different approaches (Mundt 2008: 338 ff.).

3.1 United Kingdom

Even before Margret Thatcher took office in 1979 municipal rental apartments were sold to sitting tenants. The new feature of her policy was a legal right to buy for sitting tenants and active promotion to do so. Sale prices were strongly discounted at approximately half of market prices on average. As a result, the ownership rate in the UK increased during the 1980s by 12 percentage points to 67% (Whitehead 1993). Between 1980 and 2010 British municipalities privatized some 2.3 million apartments and gained revenues of roughly £ 40 billion, which was shared between local authorities and the Treasury. Housing privatization in the UK is today assessed ambivalently. Only a small share was invested to refurbish remaining social housing stocks. But due to cost degression refurbishment became more expensive for the single unit. At the same time privatization affected those parts of the stock in better locations and better technical condition. The municipalities were left with residual parts of the housing stock with a much more problematic social structure. Privatization contributed to residualisation and hence to a stigmatization of the remaining municipal housing stock (Brown, Sessions 1997; Goodlad, Atkinson 2004). Unbalanced privatization led to local shortages in affordable housing. Supply remained higher in run-down areas, but became scarce in prosperous regions. Altogether, the right-to-buy scheme contributed to a substantial devaluation of municipal assets (Wieser, Mundt & Amann 2013).

After an increase of the ownership rate in UK to 76% in the early 2000s the share has again decreased to 67% in 2012, a stable share of 18% comprises social rent (Eurostat).

3.2 Germany

Germany had a strong limited-profit housing sector until the late 1980s, when the underpinning legislation was repealed. Since then the concept of social housing has changed fundamentally. Today social housing is not any longer defined by the legal form of the housing provider, but by a public right of allocation and public control of rent levels, which is usually connected to public subsidies.

In addition to social landlords turning to market orientation, public authorities and formerly public enterprises such as German Railways or Deutsche Post started to sell their social rental housing stocks. But in contrast to the UK, privatization targeted not the sitting tenants within a right-to-buy scheme, but private investors. In several cases such deals involved up to 50,000 units, with a peak of transfers between 2000 and 2005. Sitting tenants are protected from irregular rent increases or other immediate deterioration of rent conditions by valid subsidies, retention periods, the strict German rent law and individual social charters. To achieve the expected returns, the private investors focus on sales of individual apartments. But due to strict rent protection this turns out to be a tricky business. In some cases privatized social housing portfolios have been sold several times within a few years. There is growing complaint about non-fulfilment of social charters, pressure on tenants to purchase and degrading social management of settlements. In recent public debate discontent about the housing privatization scheme predominates.

The ownership rate in Germany is basically stable with around 53% of the total housing stock, which is one of the lowest in Europe (see Figure 1). But housing privatization leads to a shift from social rental to market rental. Social rentals decreased from approximately 10% of the total housing stock in 2005 to only 7% in 2011.

4. Housing privatization in transition countries

In shifting from a command to a market economy, most transition countries have conducted a radical privatization of housing stock since 1990. By contrast to housing privatization in many Western European countries, only one model was applied: selling off social rental apartments at very low prices to sitting tenants or handing it over almost for free. Other models, such as right-to-buy policies for sitting tenants (as in the United Kingdom), property transfers from public to not-for-profit actors (as in the Netherlands and the United Kingdom) and sale of public housing stocks to commercial investment companies (as in Germany), were not considered. The impact of housing privatization on the population has varied from country to country (UN Special Rapporteur 2009: para. 37, 39. Hegedüs et al. 2012: 41).

The starting place for privatizing the housing market was different for every country. In some countries, a private housing market had existed legally or clandestinely for many years before 1990. Although state ownership was almost total in Armenia or Russia, other countries, such as Bulgaria, Hungary and Slovenia, experienced levels of homeownership above those of Western Europe. In Czechoslovakia and Poland, co-operative housing was very important before 1990, and it continues to be important today (Struyk 2000: 3). In most Central and Eastern European countries and in Central Asia, the public rental sector has decreased from previous levels of 20-50 percent or more of the housing stock to current levels of well below 10%.

4.1 Restitution

A variation of housing privatization is restitution, i.e. the return of property rights to former owners. Restitution is implemented in situations where former shifts in property titles are perceived to be illegal, often combined with an assessment of a former political regime as illegal or illegitimate. Hence, restitution tells a lot about societies and the way that they come to terms with the past.

Only certain transition countries such as the Czech Republic, Slovenia, Poland, Bulgaria, Romania and Albania used restitution in addition to privatization. Under restitution, the rights of the former owners to regain title to their property took precedence over the rights of sitting tenants to buy the unit through privatisation. This left sitting tenants with limited tenancy rights to their current housing and often without ownership rights to any housing. In some cases, it led to eviction. Restitution provoked many disturbances, mainly because of corrupt practices and the insufficient availability of affordable housing as compensation. It is still under way in few countries of Central Eastern Europe, even though it is fading out (HFH 2005: 29. UNDP 1997; Council of Europe 2002: 17; Amann, Bejan & Mundt 2012). In countries of the former Soviet Union, restitution had hardly any significance.

However, restitution has a different dimension in post-conflict countries. In Bosnia-Herzegovina, Kosovo or Tajikistan, restitution rights have been recognised, and laws and procedures have been developed and enforced. Within this process, many displaced people have been able to return to repossess and re-inhabit their original homes, lands and properties (COHRE 2005: 4).

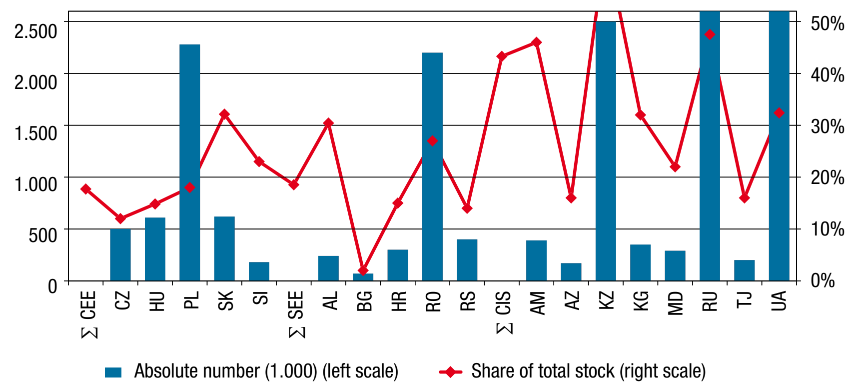
4.2 Scope of privatization

The volume of housing privatization in transition countries since the early 1990s differs a lot, ranging from only 2% of the total housing stock in Bulgaria to 65% in Kazakhstan (Figure 2). In total numbers, the biggest volume of housing privatization was conducted in Russia, with no fewer than 28.9 million units (48% of the stock), followed by Ukraine, with 6.2 million units (32%); Kazakhstan, with 2.5 million units (65%); Poland, with 2.3 million units (18%); and Romania, with 2.2 million units (27% of stock). The shares of privatized dwellings were bigger in CIS countries (approximately 43% as a weighted average) than in CEE or SEE countries (approximately 18% each), mainly because private ownership had a much lower significance in these countries before transition.

In the entire region of transition countries, covered by the IIBW/HFH Housing review on 23 countries of 2013, close to 50 million apartments have been privatized during transition, representing about 35% of the total housing stock of more than 160 million.

Privatization involved both state-owned apartments, mainly in the CIS countries, company-owned dwellings, like in former Yugoslavia, and cooperative housing, in some Central and East European countries. In many cases, privatization was not implemented directly but via a transfer of authority and property to municipalities. The sale was then organised by the municipalities.

Figure 2 Housing privatization in the ECA region



Re.: Regional shares are weighted according to the housing stock.

Source: PRC (2005), Ecorys (2005), Tsenkova (2005), Yemtsov (2007), Hegedüs et al. (2012), Struyk (2000), National Statistical Offices, Housing Statistics in the EU 2010, AHML, HFH Global Housing Index, HFH/IIBW survey 2012, IIBW.

4.3 Pricing

Sale prices under privatization almost never came close to "replacement value", a price that allows the public to build a new housing unit and hence keep the total social housing stock stable. Since privatization was never intended to be used for financing new social housing construction, this argument was hardly ever applied. By contrast, in many cases there was a consensus that sitting tenants had a legitimate claim to property rights on their apartment. Housing was in former times financed by contributions from the workers (in CIS countries to the state, in the former Yugoslavia as a fixed royalty from salaries to Solidarity Funds). As the former system of social transfers ceased to function, privatization to sitting tenants seemed to be the fairest solution to the biggest number of beneficiaries.

In most cases, sale prices were below 20% of replacement value, but in many countries the sales were free or only symbolic. Giveaway privatisation took place in Slovakia and Czech Republic, in Albania and Macedonia and in most CIS countries, including Russia.

5. Assessment of privatization

In this article we have tried to cover housing privatization both in Western European and in transition countries. But the issue differs a lot, both in quantity and quality.

For transition countries, mass housing privatization is often assessed critically or negatively (e.g., UNECE 2003, Balchin 1997: 243; HfH 2005: 29; Dübel et al. 2006; Tsenkova 2009; Amann 2009; Amann, Hegedüs, Lux & Springler 2012). The following main negative aspects are detected:

Rash implementation in an early stage of transition negated old systems before the new mechanisms were established, particularly condominium legislation and regulations on housing maintenance and management (UNDP 1997: 67). This contributed to long-lasting deficiencies in owners' associations, management and maintenance; for many countries the negative effects have still not been solved.

Privatization diminished affordable rental housing. What was good for sitting tenants up to that time became a big disadvantage for following generations. If today young households, migrants to the cities, and the poor are confronted with a very difficult housing situation, it is the result of that transitional policy.

Privatization generated plenty of "poor owners," who are hardly in a position to take over the responsibilities linked to their property. Not only can poor owners hardly benefit from the asset of owning an apartment (e.g., as security for business activities), but also they are mainly responsible for the poor effectiveness of condominium management. Being barely able to contribute financially to maintenance and repair of general parts of the buildings, they aggravate decision-making processes within owners' associations and cause improvement measures to fail. Orderly housing maintenance works only with a low share of freeloaders. If there are too many in one building, both decision-making and funding will fail. It is also more difficult to allocate housing allowances to poor owners than to poor renters, as social transfers to them are more difficult to politically justify.

It is open to question whether mass housing privatization contributed to the rapidly increasing inequality in transitional societies. There are arguments supporting this opinion, and others that emphasize the equalizing factor of everybody becoming a homeowner (Yemtsov 2007: 5).

Finally, mass privatization and the rapid increase of ownership rates contributed to the very low housing and labour mobility in transition countries, which led to negative effects on overall economic development.

With these issues unresolved, deteriorating privatized housing will in the medium term become a heavy public liability. If private owners resist taking over responsibility for repairs, this responsibility will fall back on the public authorities. Leaving unwilling owners in collapsing structures is not a political option. The public wanted to get rid of the responsibility for housing provision for the poor. This proved to be an illusion. Housing for those in need will always be a public service obligation.

But it seems reasonable to also value some positive aspects of privatization in the course of economic transition. In many individual cases, the underlying core idea of privatization to give households an asset succeeded. Ownership of the inhabited apartment was, in many cases, a starting point to achieve economic well-being. Housing privatization was probably the best visible symbol of system change to a market economy. It was therefore politically highly rational.

Ownership made it easier for many poor households to survive the later economic hardship. From a short-term perspective, this policy relieved social tension as it allowed for low housing costs for large parts of the population. Most European and Central Asia countries have housing cost ratios below the EU average (even though rapidly increasing). With the applied inadequate model of housing privatization, implementation was possible in the short term. Any complex model, anticipating problems as seen today, would have been much more difficult to implement and involved a lot of political risks. Finally, housing privatization was quite popular. People enjoyed the opportunity to become the legal owners of their apartments, as this promised security and some economic safeguard. Rapid implementation is therefore understandable.

In times of introduction of privatization laws, an increase of ownership rates was the main international trend. Policymakers all over the world believed this to be a core measure of economic development. But differentiation was missing. Among all worldwide policies to increase homeownership, the applied model of housing privatization was one of the most successful in quantity, but one of the most problematic in quality.

Initiatives in Western Europe involving mass housing privatization also had serious consequences for those housing markets. But most of them were limited in time and ended with the resignation of the principal policy makers. The lasting results of these initiatives do not compare to the recorded massive distortions caused by housing privatization in transition economies. Differences in housing privatization between West and East seem to predominate compared to similarities. In Western initiatives several hundreds of thousands of housing units were concerned, in transitional housing privatization it is several tens of millions. Western privatization initiatives took place within an operative legal and institutional environment, which did not change its basis. Transitional privatization started from scratch in terms of legal and institutional continuity. Hardly any legislation from socialist times continued in force, hardly any housing institutions survived transition.

But there are also similarities. Experience in both areas proves that privatization is an inappropriate measure for public administrations to get rid of their responsibilities for housing and the housing needs of vulnerable groups of the population. It turned out to be an illusion that housing policy can be privatized. It was also learned that an increase of ownership rates has no meaning as a political objective per se. It may be meaningful for ideological reasons. But for the time being there is no indication that increasing ownership rates contribute to social or economic performance or to the strengthening of civil society of countries. By contrast, the examples of Switzerland and Germany are frequently alluded to; both combine very low ownership rates with very high economic development.

6. Reinvigorating affordable rental housing

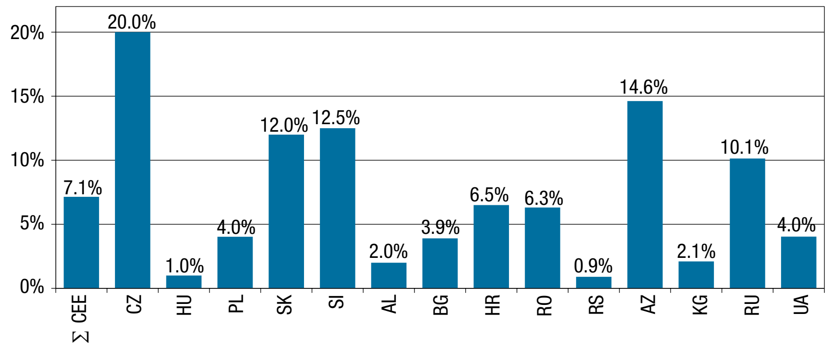
Housing policy in the ECA region has aimed quite clearly at market housing construction. Nevertheless, social housing construction has begun to recover in several countries. Even though social housing in most countries does not have the significance it has in some Western European countries, it seems to be reviving. Whereas in some Western countries social housing accounts for up to 50% of multi-apartment construction (for example, in Austria), the level is still rather low in most transition countries. As seen in Figure 3, social housing accounts for about 7% of new construction in the weighted average of the CEE countries, with no less than 20% in the Czech Republic and 12% each in Slovenia and Slovakia. The SEE countries generally have lower levels. In CIS countries the share of social housing construction differs a lot, with almost 15% in Azerbaijan and more than 10% in Russia (80,000 units in 2011).

But most of social housing construction in this area is targeted at small groups of vulnerable households at very low rents. In other cases it also includes owner-occupied tenure. Altogether, this kind of social housing construction hardly contributes to a re-establishment of rental markets in the region.

For reinvigorating affordable rental housing markets the rational choice theory should be considered. Consumer choice will generate a variety of tenure alternatives, if economic benefits, cultural status and security of different kinds of tenure are more equal. The rational choice theory has suffered from its exclusive use in promoting individual property ownership through mass housing privatization in the UK in the 1980s (King, 2010). But this theory is of course an important explanatory model for effective multi-tenure housing markets, combining different social and economic outcomes (Elster, 1989).

As seen in many Western European countries, rental housing may become a rational choice for consumers under a certain set of preconditions. It must be cheaper than mortgage payments for owning property, it must be secure and it requires a reliable institutional setting. Markets may provide such products, but only if highly developed and efficiently regulated.

Figure 3 Social housing construction, percent of total construction



Re. Data mostly as per 2009 to 2011. In a few cases, the data are older.

Source: Hegedüs, Lux & Teller 2012; UNECE country profiles; Housing Statistics in the EU 2010; AHML, HFH/IIBW survey; national statistical offices; IIBW

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Housing finance and the housing market; lessons from the UK?

By Peter Williams

1. Introduction

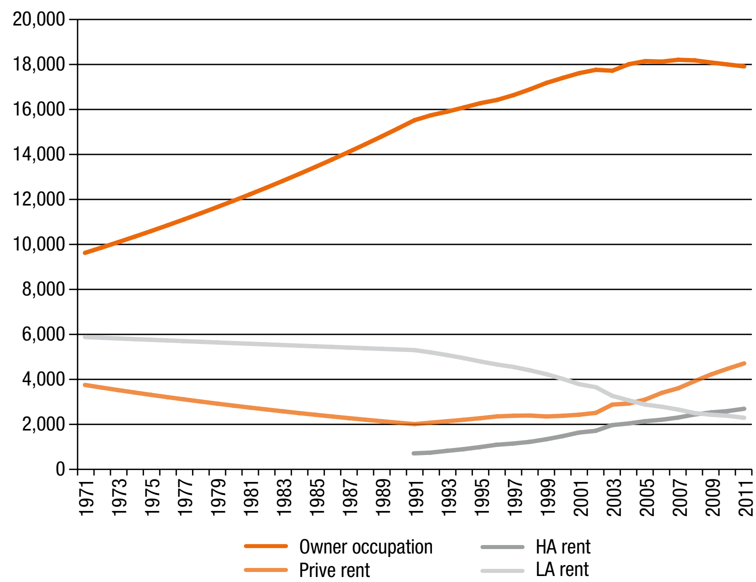
This paper builds on a presentation given at the IUHF/EFBS Conference in Vienna in 2013. The presentation sought to outline developments in the UK housing and mortgage markets over a run of years but with a focus on the period since 2007 and the global crash (Ellis, 2010) and then to reflect on underlying issues and their relevance to governments and lenders in a range of countries. This paper updates the material presented at the conference where appropriate and in particular picks up on the UK responses to what is now a global debate on macro-prudential policy and lines of intervention in mortgage markets.

2. The UK housing and mortgage markets

The UK housing system has undergone dramatic change since 1900. At that time renting from private landlords was the norm (see Chart 1). Over the decades that followed, this dominance was challenged first by the rise of public housing, mainly provided by local authorities (and since 1980 by housing associations) before the rise of home ownership, first in the interwar period 1920 to 1939 and subsequently in the post war period, notably post 1980 when through the Government's Right to Buy policy many local authority tenants were able to purchase the homes they had been renting (over 2.5 million sales took place). Over this period long run tenure patterns in the UK were transformed – private renting declined from around 90% of homes to under 10% before recovering in the last decade to around 15%, home ownership grew from 10% to over 70% before falling to 65% and social renting (from local authorities and housing associations) rose from close to 0 to around 30% before falling back to under 20%. Clearly there are important national and regional variations across the UK, for example, with Scotland having more renters and Wales more owners.

The rise of home ownership and social renting and the decline in private renting were a product of both policy and market change (Heywood, 2011). Parties of all political persuasions saw social renting and home ownership as delivering higher quality homes at an affordable cost with, in the case of owning, the added bonus of responding to demand with households acquiring a major new asset which broadly rose in value alongside wages. The government provided grants to support the building of social housing (and homes for ownership in the early years), personal subsidies to meet the costs of rents and at the same time set up a favourable tax regime which allowed owners to offset mortgage costs against their income. The government also created a 'sheltered' circuit of housing finance to secure the availability of mortgages to assist the purchase process. At the same time rent controls and other measures

Chart 1 Dwelling stock by tenure, UK, 1971 to 2011 (000s)



Source: CCHPR analysis based on Table 104: by tenure, England (historical series) by DCLG

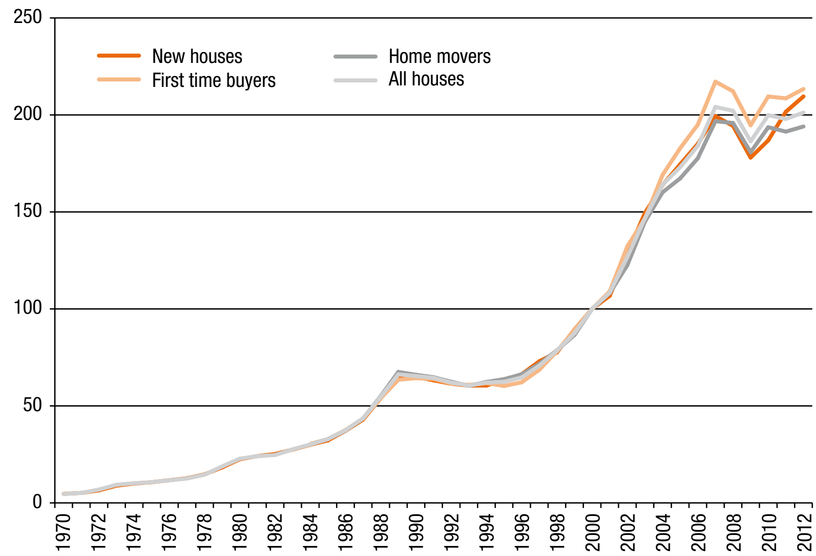
Note: LA rent includes "other public dwellings". The data from 1972 to 1990 was not available and thus estimated on the linearly changing assumption. HA rent figures were not available before 1991.

brought in to improve private rented homes actually encouraged landlords to exit the sector, often selling out to the rising tide of home owners.

In the 1980s the government deregulated the UK housing finance market and opened up the mortgage market to much greater competition. This had the effect of reducing mortgage costs and increasing the supply of loans, thus giving the UK a mechanism to support the growing appetite for home ownership. With the global decline in interest rates, an expansion of wholesale money markets (not least the securitisation market in the 1990s) and the demutualisation of a number of large building societies and their transformation into mortgage banks, the UK saw a significant growth in competition and product innovation in the mortgage market. This opened up home ownership to households who had previously found it difficult to get mortgages, for example, those with poor credit histories and the self-employed. Mortgage lending surged from around £200 billion of gross lending in the early 2000s to £360 billion in 2007 and at very low rates of interest and over long repayment terms. House prices rose accordingly and soon began to exceed increases in earnings. As is evident in Chart 2, this proved to be unsustainable not least due to the sudden contraction in funding markets reflecting the collapse of confidence in the US housing market and residential real estate assets.

Although private tenants could get a personal subsidy through housing benefit, that sector continued to decline and many assumed it might disappear altogether. Private renting was seen as a housing problem not a housing solution. Despite several attempts to revive the sector it wasn't until the mid-1990s that private renting began to grow again supported by one of the innovations that emerged in the market - Buy to Let mortgages. This fuelled an expansion driven not least by both the confidence in real estate in that period but also the decline in personal pensions and the need for alternatives which might underpin income and offer inflation-proof capital growth. Typically the investors were private households buying small numbers of homes to rent but this also resulted in the emergence of property companies with much more significant portfolios. As affordability and access to home ownership declined into the 2000s so this drove an increased demand for renting. Middle income households could not access the social rented sector so it was inevitable that the private market would provide their homes. As house prices began to tumble and mortgage access became severely curtailed so this shift was partly out of choice – households secured better quality homes than they could access

Chart 2 **Level and stability of return on investment from the housing sector compared with bank-saving and stock-market**



Source: CCHPR analysis based on Table HP7 Office for National Statistics, Survey of Mortgage Lenders.

Note: Figures for first time buyers and home movers were not available before 1984.

via home ownership and they faced no house price risk.

3. The consequences of the market collapse

It is perhaps important to stress that it was quite clear in advance of the events of 2007/08 that all was not well with the UK housing market. Affordability was becoming increasingly constrained. The number of mortgages for house purchase was in decline on an annual basis as was the percentage of households in home ownership (Williams, 2007; Whitehead and Williams, 2011). However, 2007/08 ushered in an even more rapid decline in mortgage lending, housing transactions, house prices and housing supply along with major falls in employment and negative GDP growth. Britain moved into a recession which at the end of 2013 it is still recovering from. First-time buyers were particularly hard hit as higher loan-to-value [LTV] mortgages became impossible to obtain as lenders adopted very conservative underwriting standards and credit checks. Some of the innovative mortgage products which combined higher LTV ratios along with generous credit assessments also proved problematic. The upshot of this plus the failure of the commercial loan market reflecting the more general economic malaise in the UK resulted in several mortgage banks failing. Not least amongst them were all of the converted building societies. None of them survived the downturn as independent entities and two were effectively nationalised while others were sold off to other banks (see House of Commons Library, 2011 for a useful summary).

Actions to prop up the financial system will be familiar to many as this was a global response – central banks dropped interest rates and provided emergency funding and guarantees, buying in assets and releasing cash back to the entities involved. The Bank of England was relatively slow to start offering to buy in mortgage assets but in 2008 it introduced the Special Liquidity Scheme [SLS] which allowed banks and building societies to swap any high quality mortgage-backed and other securities for UK Treasury Bills for up to three years. The SLS aimed to refinance illiquid assets on banks' balance sheets by exchanging them temporarily for more easily tradable assets. The SLS closed in 2009 and with debt repaid it was terminated in January 2012. This was followed by the Funding for Lending scheme [FLS] in July 2012 which was designed to incentivise banks and building societies to boost their lending into the economy. It allowed banks to borrow UK Treasury Bills in exchange for eligible collateral and has been a particularly successful scheme due to run until

2015. Currently around £17 billion of funding is outstanding and it has helped drive up activity and competition and reduce costs (though the Bank announced in November 2013 that it would now restrict FLS funding to small businesses and cease to provide mortgage market support from 2014). The Bank's actions along with keeping its interest rate at 0.5% since March 2009 and quantitative easing through which the Bank put more money into the economy (thus boosting activity) have been key factors in the UK's ability to get through the crash and into recovery.

The crash triggered a fundamental review of the regulation of the financial system in general as well as a review of the mortgage market (Turner, 2009). The Bank has taken over the Financial Services Authority which was created in 2001 and this entity has now been split into the Prudential Regulation Authority [PRA] and the Financial Conduct Authority [FCA] both under the control of the Bank. A new committee the Financial Policy Committee has been set up to sit alongside the Monetary Policy Committee with a focus on the Bank's financial stability objective. It is charged with 'taking action to remove or reduce systemic risks with a view to protecting and enhancing the resilience of the UK financial system'. It also has been given a duty to support the economic policy of the Government.

4. The Government's housing measures

Being very aware of the close interconnection between the housing market and the economy the government took steps to protect and enhance housing investment and to boost support to vulnerable home owners. Setting aside all of the wider financial instruments the government brought in around the housing market - a pre-action protocol which limited lenders actions in terms of repossession; an extension of the existing support to home buyers through the benefits system and the introduction of a mortgage rescue scheme and a home owner mortgage support scheme. It also brought in time limited funding schemes to boost housing supply and construction activity and introduced greater flexibility in existing schemes.

The upshot was that the combination of the measures taken for the economy and housing dampened the impact of the crash and recession on the housing market. The levels of defaults and repossessions were much lower than some anticipated and as a consequence the market was not damaged further by a surfeit of repossessed homes being disposed of at low prices. Indeed such was the impact of the government's more generous treatment of Support for Mortgage Interest payments (the equivalent of housing benefit for home buyers) and the efforts made by lenders to work with those in difficulty that the take up of the Home Owner Mortgage Support scheme was much lower than anticipated (in hundreds rather than thousands). All in all although the downturn had a big impact as measured by falls in the number of transactions and housing and mortgage supply, the UK housing market did not suffer the major falls in prices observed, for example, in the USA or Ireland and at least on some measures did not see a full rebalancing between prices and affordability with homes remaining overvalued in relation to underlying fundamentals (see Economist, 2013). In essence government helped sustain prices.

5. Where we are now?

The focus initially was on propping up the market. However as the economy slipped further into recession so the emphasis shifted towards the role housing might play in boosting economic activity. The UK government (and the governments of Scotland and Wales) took steps to encourage house building and housing activity through the creation of several new schemes including the Help to Buy equity loan and mortgage guarantee schemes, a Build to Rent programme and much more (see Wilson 2013 for details). In essence the package supports both home ownership and the expansion of private renting. The total package of assistance to the housing market including the Funding for Lending scheme advances on mortgages probably adds up to around £40 billion.

The £3.5 billion Help to Buy equity loan scheme was open to both first-time buyers and home movers. They can purchase new-build homes worth up to £600,000. The government puts in an equity loan up to 20% of the price alongside a minimum 5% deposit from the purchaser and a mortgage loan of up to 75%. By November some 2000 mainly first time households had used the scheme. The much more significant £12 billion Mortgage Guarantee scheme (covering up to £130 billion of mortgage loans) was due to be launched in 2014 (and run for 3 years) but the Chancellor brought it forward to the start of November 2013. This scheme works by offering lenders the option to purchase a guarantee on mortgages where a borrower has a deposit of between 5% and 20%. It must be a residential mortgage for owner occupancy; the property must be in the UK and the purchase value must be £600,000 or less and the mortgage must be taken out on a repayment basis, rather than interest-only. The borrower has to pass lender affordability tests. Lenders can opt as to which LTV band of loans they wish to cover – mainly 90-95% LTV and the 7 year guarantee covers the lender against losses on the top 15% the loan (assuming a 5% deposit by the borrower). The lender pays a fee for the guarantee.

These two schemes give a sense of the scale of the market interventions being made by the UK government and the importance ascribed to housing's role in the economy and of course the politics of housing provision. The government recognised that supply was lagging well behind demand – output of new homes in England is currently around 120,000 per annum when new household formation is estimated at 250,000 per annum (Holmans, 2013) so there is a growing gulf and it is estimated that up to 2 million households can either not enter the home owner market or are unable to move within it as a consequence (Savills 2013). Housing is an enduring problem in England with the shortage of supply being at the heart of the problem along with widespread and growing under-occupation of the existing housing stock.

Until mid-2013, the outlook for the UK housing and mortgage markets was still quite pessimistic, with prices stagnating and transactions and mortgage supply limited, especially at higher loan to value ratios. However since then, and partly as a consequence of wider economic recovery and the boost to confidence and activity through the housing market measures discussed above, the market has strengthened considerably (OBR, 2013). Indeed such has been the turnaround the Bank of England has engaged in pre-emptive thinking out loud about how it might step in to control the market and prevent any bubble re-emerging. In the latest BoE *Financial Stability Report* issued in November 2013 (BoE, 2013) the Bank comments in the concluding section on the prospects for financial stability;

> 'The upturn in UK house prices has gathered momentum since the June Report, with average prices nationally rising by 6.8% in October on a year earlier... The recovery also broadened regionally, with prices in nearly all regions rising. Surveys indicate that prices are expected to increase further in the period ahead. Activity also increased, but remains at relatively low levels. Further support to the housing market will come in the months ahead, including from the Help to Buy scheme….measures of valuation are below the levels reached in 2007. But some metrics, such as house price to income and house price to rent measures are above historical averages. Alternative indicators of the

> sustainability of prices, such as household income gearing, are at lower levels, though that reflects the direct impact of current exceptionally low interest rates. If UK house prices were to rise materially, or interest rates increase, these valuation measures would look more stretched. Rising house prices – and any subsequent falls – need not in themselves pose a threat to financial stability. It is the interaction of developments in the housing market with a range of factors, including household indebtedness and leverage in the banking sector, which gives rise to financial stability risks.'

The Bank then went on to note that mortgage lending was relatively subdued, higher loan to value loans were becoming more common and that 'Shifts such as these, were they to broaden and be accompanied by a deterioration in underwriting standards, would increase threats to financial stability, especially if interest rates were to rise from current low levels'. The Bank concluded that;

> 'A downturn in the housing market would also be likely to have an important impact on the wider economy, which could in turn affect financial stability. Household indebtedness is near historically high levels and some cohorts of households have particularly elevated debt to income ratios. As a result, there is a risk of sharp adjustments to household spending in response to a rise in interest rates or a fall in house prices. That could lead to weaker economic activity and rising unemployment, with impacts across a broad range of banks' exposures and on bank profitability.'

The Financial Policy Committee [FPC] of the Bank of England will be closely monitoring the housing market, looking at a number of measures including developments in house price inflation relative to indicators of affordability and sustainability plus a range of other indicators. These include the 'tail' of borrowers with particularly high indebtedness, underwriting standards in the residential mortgage market, the exposure of lenders to highly indebted households and the reliance of lenders on short-term wholesale funding. All this gives a clear sense of central bank engagement with the UK's housing and mortgage markets and in a far more explicit way than previously. These are on the back of other measures flowing through the system to both assess and develop the resilience of the banking system including close examination of the capital adequacy of major UK banks to risks arising from housing-related portfolios, stronger mortgage underwriting standards as part of the Mortgage Market Review including an affordability assessment with an interest rate test to gauge borrowers' resilience to rising rates, all of this aligned with the global FSB *Principles for Sound Residential Mortgage Underwriting Practices*.

The FPC has considered what steps it should take to address potential risks in the housing market and it has made a series of recommendations including that the FCA should require mortgage lenders to have regard to any future FPC recommendation on appropriate interest rate stress tests to use in the assessment of affordability. It also set out possible interventions including taking action to enhance lenders' balance sheets by varying capital requirements and/or the capital buffer and by applying requirements to specific types of mortgage lending, just to new lending or to the entire portfolio of loans. It could also recommend that regulators curtail the extension of mortgages with certain characteristics, e.g., high LTV loans or loan to income ratios of mortgages. The FPC has also a specific role with respect to the Help to Buy regime and how it might be amended or removed.

6. Housing, the economy and the state

The Bank's recent but sudden move to refocus the Funding for Lending scheme gave a sense of how it might act in the future – the changes are phased and impact over time. In hindsight they are proportionate and sensible and measures the market can absorb and move on. Having set out what it might do we now have a sense of how it might do it and broadly the market is comfortable with this new interventionist agenda (CML, 2013). However it does show how important the housing and mortgage markets have become not just in the recovery but in the general running of the economy.

Over the years there has been considerable debate about the relationship between the economy and the housing market (Muellbauer and Murphy, 2008). In broad terms it was ignored. However in recent years that picture has changed with the focus on recession and recovery being a key element in that process (see Regeneris and Oxford Economics, 2010 but also DTZ, 2006; Doling et al 2013). In a report published in 2011 the UK Confederation of British Industry set out a strong case for investment in housing reflecting the sector's strong multiplier effects (CBI, 2011: £1 of housing spend generates £3 of activity) and this message about the efficacy of housing investment (and the speed with which that impact feeds through) has been widely absorbed and is central to the government's current policy stance.

However this new focus has its downsides for the industry. In the UK it has meant much closer scrutiny of what is happening in housing (and the role of individual sectors such as house building, mortgage lending and private investment) and it has fed through into a greater appetite to intervene even though the broad sentiment of the UK government is a 'smaller state' and less intervention. The focus has shifted to addressing perceived market failures with short-term spending interventions to boost market activity. Clearly this is a difficult balance to maintain and not least because there are still competing views about whether or how to intervene, for example on housing supply. Should government set up a temporary mass building programme, or should it seek to improve the speculative house building industry's performance or should it just leave the market to fix itself? What we have seen is that although government has been unwilling to lock itself into big long term spending plans there has been a new focus on innovative types of funding – notably loans and loan guarantees, a new emphasis on the use of assets and the maximisation of efficiency and private sector finance, attempts to remove market blockages to speed up responses and finally bringing in new skills around making markets. In the very recent past the UK government was strongly opposed to guarantee powers claiming it would result in long term spending liabilities. However, coming out of an economic trough where the likelihood is that asset values and performance will improve, guarantees have now become widespread as a mechanism for boosting confidence and activity.

Thus the role of the state has evolved and we see a new engagement with the market blending the role of the state alongside the power of the market. Given housing's prominence in terms of driving recovery little wonder then that we have seen the suite of measures discussed above. But to re-iterate, the issues then become both how such programmes are withdrawn without a 'cliff edge' effect on market recovery and also what controls and sanctions are imposed.

7. Conclusions; the UK in a global context

This article has sought to chart in broad terms the evolution of the UK's housing and mortgage markets over the last decade, through the crash and recession and progress through the subsequent and continuing recovery. It has sought to stress the importance of housing in this process both in terms of market impacts and government interventions. Indeed the scale of the interventions in the UK housing and mortgage markets is very big and wide ranging by international standards. Despite or perhaps partly because of them the UK markets have also undergone a fundamental transformation. Home ownership has declined and private renting has increased while social housing is being reworked.

The question then is are these changes likely to be cyclical or structural and the answer is probably both! There are important structural shifts in the control and regulation of the UK mortgage market that 'hard wires' certain limits into the housing market through more restrictive access to mortgages. There are differing views as to the scale of this and the government has moved in recent months from what might have been termed a clear policy of tenure neutrality to a somewhat more ambiguous position where it is strenuously proclaiming its support for home ownership while at the same time working hard to expand the private rented sector. The government has recognised that having a small private rented sector means that when home ownership comes under strain it has little choice but to expand its social housing programmes. While it is recognised that an expanded private rented sector is not cost free, for example because private rents are higher than social housing rents, expansion of this sector has triggered a sharp rise in housing benefit costs. This has encouraged government to think about expansion driven by private investors, and not least pension funds (since rents provide a good match with pension liabilities) and outside of government spending capacity.

Given the likely outlook on public finances over the medium term it is highly probable this will become a core housing policy regardless of the party/parties in power. So the UK (or at least England) has moved from a housing system dominated by social renting and home ownership to one where we are more likely to see private renting and home ownership as the main tenures. In stepping back as a funder/provider of social housing the government then becomes more reliant on the market and has balanced regulatory interventions to ensure good consumer outcomes against its reduced direct role. It also has to think about the opportunity costs of putting personal and other subsidies into the private rented sector (and ultimately to profit landlords and investors) against social housing provided by public or non-profit providers at below market rates.

Reinforcing the role of the market at the centre of housing provision poses other challenges, as is evident in the post-crash global debate on macro-prudential regulation and sectoral interventions and not least in relation to the housing market. Given the role house prices and housing markets played in the crash it is little wonder that worldwide the regulators have been giving attention to how they might control future housing bubbles and related activity. A recent Federal Reserve Bank of Dallas conference on *Housing, Stability and the Macroeconomy: International Perspectives* (see http://www.dallasfed.org/research/events/2013/13housing.cfm) brought together regulators and analysts and highlighted the new engagement around this issue. The discussion earlier on the deliberations of the Financial Policy Committee outlined the direction of UK thinking (see also Miles, 2013) and a number of countries have introduced forms of restriction on debt-to- income ratios or mortgage term to restrict mortgages, including Canada, Hong Kong, Korea, Singapore and a number of EU countries. New Zealand has recently introduced a limit on the proportion of new lending above 80% loan to value. All have been aimed at reducing housing market activity and price pressures though with varying results.

What we can observe in the UK are a number of transformations over time, which tell us that arguments about permanence and inevitability of certain housing market structures can be somewhat misplaced. The UK has moved from being a society dominated by private renting in 1916 to one where home ownership and social housing made the running in the post war period. Although this balance was shifting in the last decade of the 20th century and onwards the credit crunch has driven forward the rise of private renting and put further momentum into the contraction of home ownership and social housing. How this rebalancing will play out over the next few decades is uncertain but it seems likely we will see a dis-engagement in directly funded housing provision and a move towards targeted short-term interventions along with macro-controls on the market. This further exposes the government to the risks that the market will not deliver what is needed and not least in terms of securing a massive increase in housing supply. This in turn may mean the UK will see continued market volatility with all the economic and political tensions that brings. That in turn may usher in a new era of intervention though not in the form of direct provision but rather in the area of property taxation.

The ebb and flow of the market and policy pose significant challenges for the mortgage industry in terms of the scale of likely demand for mortgage funds, product innovation and pricing. In a sense it has always been so but now the regulatory armoury is bigger and more encompassing with a global commitment to act rather than observe. It puts a new premium on lenders to better understand the environment in which they are working and how it might evolve.

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Public housing in Shanghai: a tool with multiple purposes

By Ying Chang and Jie Chen (corresponding author)[1]

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1. Introduction

It has been argued that many aspects of urban dynamics are strongly affected by local housing policy (Glaeser et al., 2006). Public housing is perhaps the most controversial housing policy as it is in direct competition with market rate housing and also costly to implement and maintain (Green and Malpezzi 2003). Nonetheless, direct state provision of housing remains an important element of housing regimes in many countries. As suggested by Green & Malpezzi (2003), "political support is generally stronger for programs tied more closely to the consumption of specific goods (housing, food, and medical care) than for income support".

Being a developmental state, the Chinese state envisages economic growth as the most important means to earn the political legitimacy to govern. From 1998 to 2011, China witnessed an unprecedented construction boom with more than 9,300 million square metres [sqm] added to the residential stock, which made it possible to shelter the 280 million population that migrated from rural areas to urban areas. However, as Wu (2001) pointed out, China's post-reform housing policy has embedded two interrelated but contradictory objectives: on one hand, to increase affordable housing supply sufficiently to accommodate rapid urbanization through commoditization and marketization of housing; on the other hand, to stimulate local growth through enhancing the attractions of profit-driven real estate investment.

In recent years, the embedded contradiction within housing policy has been aggravated to produce a number of threats to the state's political legitimacy, which include a general worsening of housing affordability (Chen and Mark, 2010), rampant property speculation, residential inequalities (Li and Wu, 2006) as well as increased macro instability. To confront these threats, since 2009 the Chinese central government has been mandating all municipalities to construct large-scale public housing projects (Wang & Murie, 2011). In spring 2011, the State Council promised to deliver 36 million units of public housing during the period of "the 12th Five-Year Plan [FYP]" (2011-2015). This ambitious program is expected to house 20% of Chinese urban residents by 2015.

However, it is still widely believed, in China "(the) state housing provision is seen as important economic drivers rather than socially necessary" (Wang and Murie, 2011). Nonetheless, according to the new doctrine of a "harmonious society" proposed by Chinese President Hu Jingtao in 2006, social welfare policy should be more integrated with economic policy and therefore also become a new benchmark for ranking the success of Chinese local leaders. For example, a recent joint report released by the World Bank and the Development Research Center of the State Council of China [DRCSC] suggests that China's future version should be either the "active welfare society" or "developmental welfare" model (World Bank 2012: pp298).

Like HDB housing projects in Singapore (J. Wang 2012), the new public housing sector in Shanghai has been designed to serve as a platform to weave together a hybrid of ideologies such as neo-liberalism, interventionism, authoritarian capitalism and developmentalism. Particularly, as we show in this paper, the new PRH (Public Rental Housing) scheme in Shanghai is a result of deliberate urban development policy aiming to contribute to city marketing as well as the making of new gated neighborhoods for the middle class. Overall, we assert that the Shanghai municipality government aligns her public housing program mainly to reinforce local economic competitiveness and provide stability.

2. Current conditions and recent development

2.1 The current housing conditions in Shanghai

With a total population of more than 23 million and an annual GDP of 1,920 billion RMB (ac. 297 billion US$) in 2011[2], Shanghai is the largest as

[1] Jie Chen is Professor at the School of Public Economics and Administration, Shanghai University of Finance and Economics; Ying Chang is Assistant Professor at the Department of Urban Planning and Design, Xi'an Jiatong-Liverpool University"

[2] By the official exchange rate Shanghai's GDP was ranked the 13th among all cities in the world in 2011. Source: http://en.wikipedia.org/wiki/List_of_cities_by_GDP.

well as the most globally vibrant city in China. Like other Chinese cities, Shanghai's neo-liberal transformation of housing provision since the 1980s has been primarily driven by the state-led shift from the central planning system to the socialist market system (Wang & Murie, 2011). Since the late 1990s, globalization has in conjunction with market reform shifted housing demand and housing supply in Shanghai (Shen and Wu 2012; Wu 2001; He and Wu 2005). Housing development since the 1990s has significantly transformed the ownership structure of Shanghai's urban housing stock. By the early 1980s, 80% of the urban housing stock in Shanghai was owned by the state (including working units) and only 20% belonged to private persons (Shanghai Statistics Yearbook 1983). However, in 2011, 85% of Shanghai permanent residents owned their home.

Neo-liberalism stimulated an investment boom in the housing sector. By the end of 2011, the total housing stock in Shanghai amounted to 550 million sqm, which is 13.4 times that in 1978 and 2.9 times of that in 1998. The average living space per person in the urban area is 18.7 sqm in 2011, doubled from 1998. The quality of housing also has increased significantly. In 2011, low-standard housing (mainly shanties and old lane houses) amount to only 1.46% of total residential stock.

According to the 6th population census, Shanghai accommodated 23 million residents (8.25 million households) in 2010. Among residents, permanent households (with local registration status-*hukou*) account for 61% and migrants (without *hukou*) account for 39%. The overwhelming majority of the migrant population is rural-urban migrants.

The census data reveals a sharp disparity in the homeownership ratio between permanent households and migrant households: 80% vs. 20%. Meanwhile, among all households, 7.4% are living in accommodation without plumbing, 15% without toilet (7% share toilet with others) and 27.2% without bathroom. The demand for decent housing is still tremendous, particularly among rural-urban migrant workers.

The literature also reveals that the socialist legacy together with the force of neo-liberal marketization has concentrated low income households in certain types of dilapidated urban neighborhoods (He, Wu et al. 2010).

Table 1: Tenure distribution structure of permanent households in Shanghai (%)

TENURE TYPE	2004	2008	2010	2011
Rental	26.6	21.6	19.9	17.19
Public rental (pre-reform public housing stock)	25.9	17.4	16.4	13.89
Private rental	0.7	4.2	3.5	3.3
Home Ownership	72.9	77.6	80.1	82.09
Owned: inherited from older generation	2.2	0.7	0.7	0.89
Owned: privatized pre-reform public housing	42.9	37.8	37.4	37.9
Owned: self-purchased commodity dwellings	27.8	39.1	41.1	43.3
Other	0.5	0.8	0.9	0.69
Total	**100**	**100**	**100**	**100**

Source: Shanghai Statistics Yearbook 2005-2012

Table 2: The structure of residential housing stock in Shanghai (1949-2010) unit: 10,000 sqm

YEAR	Total	Villa	Apartment	Staff dwelling	Improved lane houses	Old lane houses	Shanties
1949	2,359	224	101		469	1,243	323
1950	2,361	224	101	1	469	1,243	323
1960	3,602	224	101	500	478	1,800	500
1970	3,871	225	101	741	492	1,853	459
1978	4,117	128	90	1,140	433	1,777	464
1990	8,901	158	118	4,884	474	3,067	123
1998	18,587	214	191	14,868	445	2,758	49
2000	20,865	250	206	17,939	428	1,896	84
2005	37,997	1,380	491	33,610	541	1,836	37
2010	52,640	2,064	492	47,951	528	1,275	29

Source: Shanghai Statistics Yearbook (1985, 2000, 2011)

2.2 The post-reform public housing system in Shanghai

Despite the dominating role of the market in the post-reform housing provision, the Chinese government never fully withdraws from the housing sector. In 2001, Shanghai became the first city in China to set up the Cheap Rent Housing [CRH] system. The poorest households living in overcrowded dwellings are entitled by right to receive subsidized rents or cheap accommodation from the local housing authority. However, the CRH is proposed as a residual welfare scheme with strict entry requirements. By the end of 2009, only 61,500 households were assisted by the CRH program (roughly 90% in the form of rent allowance and only 10% in the form of subsidized accommodation). This number accounted for only 1% of permanent households in Shanghai.

Until 2009, municipalities in China had almost full autonomy on decisions regarding the quantity and mode of public housing provision. The incentive to provide public housing was primarily driven by internal pressures and objectives, subject to the constraints of local government's resources. However, since 2010 the central government has placed public housing provision as a priority on its social and political agenda (MOHURD 2011). The scale of public housing construction has expanded substantially: the national target has been lifted from 1 million units in 2008, to 3.3 million units in 2009, 5.9 million units in 2010 and 36 million units over the 12th FYP (2011-2015). Meanwhile, since 2010 the Ministry of Housing and Urban-Rural Development has set strict guidelines as well as annual targets for public housing provision for each municipality (MOHURD 2011).

In 2008, Shanghai reintroduced the Economically Affordable Housing [EAH] programme. Similar to EAH programmes in other Chinese cities (Y. P. Wang and Murie 2011), Shanghai's EAH programme aims to increase the homeownership ratio among "house-poor" low-middle income households. To ensure affordability, housing is built on government allocated land, exempted from various fees and taxes and the benchmark sales price is set based on construction costs. Units are also regulated at around 60-80 square meters. Occupants have restricted ownership rights over their homes and face restrictions in reselling, i.e., a 5-year resale restriction period. In Shanghai, the EAH has been sometimes been called "shared-ownership" housing. This name comes from the fact that the government and buyers share roughly between 50% and 70% ownership of EAH respectively. This is a measure that helps to prevent the applicants purchasing EAH homes for investment purposes. By 2010, 10 million sqm of EAH homes had been constructed in Shanghai.

In 2010, nearly twenty years after the termination of welfare rental housing, Shanghai Municipality adopted the Public Rental Housing [PRH] Programme and branded it as one element of the 'four in one' comprehensive public housing polices. The central idea of the 'four in one' model is to provide different types of affordable housing for different groups: the Cheap Rent Housing for the poorest households; the EAH (Shared-ownership) for the low-middle income households; relocation housing for the households displaced by the government; and the PRH for those who cannot afford home ownership but are also excluded from the other three affordable housing programmes. The PRH program is the only scheme open to non-*hukou* holders, however still with an eligibility condition of the possession of a long-term residence permit.

According the Shanghai Housing Development Plan for the 12th FYP (2011-2015) published on Feb.7, 2012, the supply plan for public housing in Shanghai between 2011 and 2015 is one million units in total: 400,000 units for EAH; 350,000 units for relocation housing; 75,000 units for CRH; and 200,000 units for PRH. The land supply for affordable housing, together with small-medium size commodity housing, would be about 700 to 800 hectares per year from 2011 to 2013, making up 70% of the total land supply.

Table 3: The supply plan of the "Four-in-One" public housing in Shanghai (2011-2015)

	2011-2015 (target of net increase)	
Types	Units(1,000)	Population Coverage (%)
Cheap Rental Housing	75	1.5 (2.6)
Economical Affordable Housing	400	4.2 (7.6)
Relocation Housing	350	3.5 (6.0)
Public Rental	200	1.2 (1.9)
Total	**1,000**	**11.8 (19.2)**

Source: Shanghai Housing Development Plan for the 12th Five-Year Planning Period (2011-2015)

Note: in parentheses are referring to permanent households only and out parentheses are referring to the whole resident households, including floating migrants. The population in 2015 is the author's own estimation. For Cheap Rental Housing and Public Rental housing, the figures include the additions from the purchase or conversion of existing housing stocks.

Table 4: The planned land supply in Shanghai between 2010 and 2012 (in hectares)

YEAR		EAH	Relocation Housing	Public Rental Housing	Small-medium size commodity housing	Others	Total
2010	Hectare	250	450	0	70	330	1100
	percent	(23%)	(41%)	0%	(6%)	(30%)	
2011	Hectare	200	400	100	140	360	1200
	percent	(17%)	(33%)	(8%)	(12%)	(30%)	
2012	Hectare	100	450	50	100	300	1000
	percent	(10%)	(45%)	(5%)	(10%)	(30%)	

Source: the 12 FYP of Land Supply in Shanghai

Note: there is no land supply plan for the Cheap Rent Housing and there was no land supply for PRH in 2010.

3. Urban redevelopment and public housing in Shanghai

3.1 Key concepts: entrepreneurial city, city marketing and gentrification

As argued by some of the literature, Shanghai has embraced a state-led development approach but functions as an entrepreneurial city when paving its way to reclaim it global status (Wu 2003; He and Wu 2005; Zheng 2010).

City marketing is one of the main features of an entrepreneurial city, and particularly for cities that have embraced global competition. Sager (2011) emphases the neo-liberal rationale behind it, 'city marketing, promotion and branding are means for achieving competitive advantage in order to increase inward investment and tourism' and two groups of 'placer customers', together with the visitors, are usually the targets of city marketing drives: specifically, (1) inhabitants that want an attractive place to live, work and relax, (2) companies looking for a place to locate their offices and production facilities, do business and recruit employees (Sager 2011, p157). Important means used in city marketing include flagship projects and mega events (e.g. a Formula One race event and the well-known World Expo 2010 were held in Shanghai). In Shanghai, the city has employed various preferential policies to create an attractive image as an ideal place for industrial development and financial investment (Marton and Wu 2006; Wu and Barnes 2008); Creative industry clusters have been tossed into a hub to host world famous cultural and artistic events (Zheng 2010). It is also suggested that Shanghai manifests a complicated relationship between gentrification, globalisation, and emerging neo-liberal urbanism, and the local state has played a leading role in the large scale gentrification in Shanghai, mainly through the strategic plan (He 2010).

3.2 Relocation housing and gentrification

Many have investigated how the Shanghai municipality, as an entrepreneurial government, uses land as an important revenue generator (F. Wu 2004; He and Wu 2005; Yang and Chang 2007). Meanwhile, the Shanghai municipality has a long history in using public housing to promote urban redevelopment. The following sections will elaborate on the multiple purposes which the relocation programme in Shanghai serves in the process of inner city redevelopment and gentrification.

From 1987 to 1995, Shanghai implemented a small-scale "*housing congestion alleviation*" programme for those with the problem of extreme overcrowding (MOST 1995). A total of

60,000 households were resettled under this programme (Wu 2004).[3] Since 1992, the "365 scheme" of urban regeneration was introduced with the aim of redeveloping 365 hectares of shanty housing by 2000. The successful accomplishment of this scheme was largely associated with real estate developers who sought to share the profits of land redevelopment with local governments (Wu 2004).

The redevelopment of the inner city in Shanghai continued on a greater scale in the post-reform era. In 2001, the "new round redevelopment scheme" was proposed with an aim of redeveloping nearly all dilapidated neighborhoods in the central areas. However, after commodity housing prices in Shanghai began to soar from 2002, the relocation compensation costs for displaced households increased dramatically (He and Wu 2005). To reduce displacement costs and facilitate the redevelopment of inner cities, the relocation housing policy was designed in 2003.

According to the new displacement policy implemented in 2003, displaced households receive compensation at least equal to the market value of their demolished housing and have the right to buy the relocation housing at the price usually capped at roughly 70% of nearby comparable free-market housing. High housing prices in the center and the substantial price gap between relocation housing and market housing in the suburb provides large incentives for households faced with relocation to move.

In 2005, the Shanghai Municipality announced a plan to provide 10 million sqm of relocation housing and 10 million sqm of Capped Priced Commodity Housing; the so called 'two 10 million sqm' programme. However, this scheme was suspended in 2006. Nonetheless, relocation housing continued to be built on a large scale: over the 11th FYP (2006-2010), 29.6 million sqm or roughly 330,000 units of relocation housing were completed. According to the Shanghai Housing Development Plan of the 12th FYP (2011-2015), 150,000 downtown households would be displaced and 3.5 million shanty housing in the inner city would be demolished.

The following table shows that a total of 1,159,899 households were displaced from the central area between 1995 and 2011, with a constructed residential area of 76.65 million sqm being demolished. This data suggests that, roughly one in four (permanent) households in Shanghai experienced forced relocation. It can be reasonably inferred that, without large-scale population relocation and land use restructuring, the housing stock in the urban area would be much less than the current level.

Table 5: Residential relocation and housing demolition in Shanghai (1995-2011)

Year	Displaced households	Demolished residential space (10,000 m^2)
1995	75,777	253.90
2000	70,606	288.35
2005	75,857	851.85
2006	81,126	848.35
2007	51,354	690.00
2008	53,583	753.71
2009	68,286	612.56
2010	39,721	389.87
2011	23,112	182.83
Total	1,159,899	7,665.2

Source: Shanghai Statistics Yearbook (2012)

Note: Data only covers nine central urban districts and Pudong new district.

The 12th FYP of Shanghai points out that relocation housing has become a central tool to promote urban redevelopment and its 400,000 unit construction target over the period of 2011-2015 is decisive for the success of urban development in the 12th FYP. Relocation housing is the one of the biggest segments of public housing in Shanghai and the land supply for it is prominent in the overall supply, with a total of 450 hectares, making up 45% of the total land supply in Shanghai in 2012 (see Table 3-4).

Both dilapidated neighborhoods and work compounds were the primary location of low-income households, who have been relocated to the outskirts. The original impoverished neighborhoods are replaced by high rise commodity housing that mainly accommodates the upper and upper-middle class. The blighted industry areas are also replaced by shopping centers, offices and banks.

The relocation housing programme is thus an outcome as well as a response to state-led urban development approach. There is ample evidence that the relocation-housing programme in Shanghai as a whole has contributed to alleviate the level of overcrowding of poor households in dilapidated neighborhoods (He and Wu 2005; Yang and Chang 2007; Weinstein 2009; S. W.-H. Wang 2011). However, the price of the trade-off between good location and housing overcrowding is not accounted for. Further, the interests of displaced poor renters are largely ignored; it must be understood that often owners of overcrowded dwellings in fact do not live there and rent out to migrant workers.

4. The development of new public rental housing in Shanghai

The new Public Rental Housing (PRH) programme has become a national priority of housing policy in China. Since 2011, the provision of PRH has become one of the key indicators to evaluate the performance of local municipalities.

4.1 Features of public rental housing in Shanghai

In Shanghai, the supply plan of PRH units in the 12th FYP (2011-2015) is 200,000 units, half of which is to be provided at the city level and half at the district-level. By 2012, 21 PRH companies were established in Shanghai.

These PRH companies are legal independent entities, with investments shared equally between the city and the district. The PRH company is responsible for the investment, planning, design,

[3] In 1987-1988, the standard to qualify for entering this programme was households with housing space less than 2 sqm per person. This standard was lifted to 2.5 sqm in 1991 and 4 sqm in 1995.

administration, and management of the PRH. It is financially independent, which means that for additional costs beyond the initial investment, they have to finance themselves. In this respect, the PRH Company in Shanghai resembles the municipal housing company in Sweden and social housing cooperatives in the Netherlands. However, it is still unclear who will finance the operating deficit of the PRH Company if it occurs.

According to the governmental policy statement[4], the principles of PRH in Shanghai can be summarized as 'led by the government, supplied by multiple sectors, provided at market price, and subsidised by multiple means'. Specifically, the government is responsible for the policy making, planning, organising and coordinating different sectors in the implementation. Both public and private sectors could be the suppliers. The rental price is at market level and the gap between the market price and affordability should be met by the subsidy shared by the municipality and employers.'

It needs to be noted that although no permanent register status (hukou) is required, the applicant has to possess a long-term residence permit and have continuously contributed to the social insurance account for at least 12 months. Since summer 2013, the application for a residence permit has changed into a points-based system, which gives higher scores for candidates who are of younger age, have higher education, higher skilled, and who work in sectors within short-listed or remote new towns. In the following sections, we borrow the term 'talented class' (rencai in Chinese) to refer to these groups who are welcomed (or selected) by the city of Shanghai[5].

In short, the new PRH programme in Shanghai is tailored for:

a. Talented class members who cannot afford homeownership via the market while not eligible for other affordable housing programmes, for instance, the EAH;

b. Residents who live in overcrowded housing; this implies that homeowners can also apply for PRH, as long as their construction space per person is less than 15 sqm.

It should be emphasized that the rental rates of PRH in Shanghai are only slightly lower than the private rental market price. We will elaborate on the implications of this point in later sections.

4.2 The demand for talented class and PRH

Shanghai has been given a role by the state as the 'dragonhead' to lead the 'opening up' policy in the post-reform era, with an ambitious aim of becoming a global financial centre. A strong relation has been found between economic globalisation and the marketization of the socialist system in China (Witt and Redding 2013). Meanwhile, it has been suggested that globalisation and competitive strategies are bound together for reshaping the landscape of Chinese cities (Xu and Yeh 2009). There is also significant literature on the diverse city marketing and place promotion methods used in Shanghai (F. Wu 2001; Wei et al. 2006; Yang and Chang 2007).

To meet the growing demand of an entrepreneurial city, Shanghai needs more human inputs as the engine of the city. However, if one considers only permanent residents (*hukou* holders), Shanghai has been an aging city since early 1990s. The latest Census in 2010 shows that the ratio of aged 60 and above was as high as 23% amongst permanent residents. The natural population growth rate among permanent households was -0.6 ‰ in 2010. The impact of the aging issue is not just the reduced larbour force but also pressure on the social insurance fund.

The decentralization of the fiscal regime has permitted Shanghai to embark on its entrpreneurial jouney. However the lack of contributors to the social insurance fund has weakened the fiscal system. In addition, Shanghai is faced with the growing competition from neighbouring cities in the Yangtze delta for high-skilled workers.

As summarized by Sager (2011, p157), 'the creative class needs places for consumption, recreation, and living… Furthermore, housing the creative class requires a shift from working class quarters to hip, varied and good quality residential areas.'

The importance of providing decent housing to talented people has been repeatedly highlighted in government documents and meeting minutes. The 12th FYP Development Plan of Shanghai states that, '*it is a crucial time for Shanghai to fulfill its goal of becoming 'four centres' and a global metropolitan, but we are faced with many challenges… we need more innovative public policy for the talented class, and improve the living and cultural environment for the talented class.*'

The slogan above is not an initiative but a formal recognition and adoption of recent practices to link housing to employment. As early as the late 1990s, many joint ventures in Shanghai bought 'commodity' housing for their employees to attract capable staff (Wu 2001). Since mid-2000, Zhangjiang High-Tech Industrial Park has provided 'apartments for talented professionals' (*rencai gongyu*) of 270,000 sq, mainly by using industrial land[6]. Recently, the mass media has reported a new phase of work-unit housing (for example, the Shanghai Baoshan Iron and Steel group, Shanghai Railway Group provides dormitories for their employees by using their own land for industrial purposes)[7]. On the other hand, another type of apartment, 'the apartment for talented professionals' (*rencai gongyu*) has also emerged in Shanghai in recent years. In 2011, the Changning District collected 500 units of apartments for the 'talented professionals' mainly by adaptive reuse of vacant office buildings, hotels, and industrial buildings. The tenants can receive a heavy rent subsidy from the government[8].

These initiatives have helped to frame the new PRH programme. In the 12th FYP of Talents Development Plan in Shanghai, the preferential policy of PRH as a means to attract the talented class has been highlighted: *(We need) to improve the living environment for the talented people. To build public rental housing and to moderate the **temporary** poverty in housing for young talented people.*'

The official document of the municipal housing authority also clearly states that the main aim for PRH in Shanghai is 'to relieve the housing pressure for young employees, the talented professionals and other migrant workers residing in Shanghai'.[9]

However, a rent level close to market rate has excluded those low-income households from the PRH programme. From this perspective, PRH is a very selective programme with a clear target to attract the 'talented class' but gives little consideration to solving the affordability problems of those low-income migrants.

[4] http://www.shfg.gov.cn/fgdoc/qyfc/zfbz/201202/t20120229_540238.html

[5] http://www.12333sh.gov.cn/200912333/2009xwzx/zxdt/201306/t20130619_1148975.shtml

[6] http://news.hexun.com/2011-12-18/136420803.html

[7] http://www.21cbh.com/HTML/2010-1-8/161128.html

[8] http://sh.people.com.cn/GB/134952/211179/215602/15533216.html

[9] http://www.shfg.gov.cn/fgdoc/qyfc/zfbz/201202/t20120229_540238.html

4.3 PRH projects and a survey report of its tenants

This section provides basic information on the first two municipal-level PRH projects in Shanghai (Shangjing Gardern and Xinning Apartment). The two projects provide 5,100 units of apartments in total and have been available for rental application since March 2012. Unlike most commodity housing in China which is unfurnished at the delivery stage, the PRH apartments are furnished and approved applicants can move in immediately. By the end of 2012, roughly 2,400 tenants lived in the two projects.

From the table above, it can be seen that the investment costs of PRH projects in Shanghai are very high, around 10,000 RMB per sqm in both cases. Because the PRH rent has to be capped at the market level, the annualized rent-price ratio is much less than 1:20, which implies that the investment cost needs at least 20 years to be recovered from the cash flow of rent revenue.

Further, as the PRH rent rate does not have much advantage compared to that of nearby private rental housing, the two PRH projects have not received much welcome among potential users.[11] A high vacancy level aggravates the financial balance of PRH owners. However, so far the municipality largely seems to treat the provision of PRH as a political task (a pilot project) and little consideration has been given to cost recovery as well as sustainability of PRH projects.

To understand who has been attracted to the new PRH project, we provide analysis of the characteristics and housing satisfactions of PRH tenants, based on a survey of the residents of the two PRH in Shanghai (sample size 333 in total, 128 from Shangjin Garden and 205 from Xinning Apartment). This survey was conducted during June-Oct of 2012 by the Center for Housing Policy Studies (CHPS) at Fudan University.

The survey shows that most PRH tenants are middle-class: 64% of survey respondents report their personal annual disposable income as higher than 60,000 RMB, 30% higher than 90,000 RMB and 13% higher than 120,000 RMB (note that the mean level of annual disposable of Shanghai residents in 2011 was 36,230 RMB). Further, the PRH tenants are mostly young and middle-aged: 65% of respondents are aged below 35 and 44% younger than 30; only 14% older than 50. In addition, a high education level is one of the main features of PRH tenants: 65% of respondents have received a Bachelor degree or higher.

Table 7: Basic information of the first two municipal PRH projects

	Shang Jingyuan Garden	Xinning Apartment
District	Yangpu	Xuhui
Investment cost (billion RMB)	14.98	22.5
Total Construction Space (m^2)	158,562	192,000
Total residential space (m^2)	151,818	172,000
Cost per sqm (RMB)	9,500	11,700
Units of apartments for rent	2,201	2,900
Units rented out by the end of 2012	1,581	843
Occupancy ratio (by 2012)	71.9%[10]	29.1%
Apartment size (m^2)	1-bed room:50-68 m^2; 2-bed room:67-72 m^2; 3-bed room:80-82 m^2	1-bed room:40-42 m^2; 2-bed room:62-63 m^2; 3-bed room:75-78 m^2
Distribution of housing size (units)	1-bed room: 100; 2-bed room: 2,001; 3-bed room: 100	Mostly are two-bed room apartments
Monthly rent per unit (RMB)	1-bed room:1970; 2-bed room:2540-2930; 3-bed room:2970-3240	1-bed room:1694-1896; 2-bed room:2533-2772; 3-bed room:3033-3311
Monthly rent per sqm (RMB)	Ca. 40	Ca. 45
(annualized) Rent-price ratio	1:23	1:24

Source: authors' summary based on government documents and media news reports.

Note: The two PRH projects were converted from purchased completed but undistributed public housing projects; EAH in the case of Shangjing Yuan and Relocation Housing in the case Xining. The investment costs in the table refer to the purchase prices of the two PRH projects, respectively. However, the decoration costs (around 700-800 RMB per sqm), furniture and facility costs and property management costs have not been added to the two figures yet. On the other hand, the PRH tenants do not pay the property management fee separately, as it is already included in the monthly rent.

The recent survey also shows that the majority of PRH feel satisfied with the overall quality of the PRH project: 59% of respondents think PRH meets their expectations and 17% think PRH is beyond their expectations. However, 24% feel PRH failed to meet their expectations. The aspects of PRH that respondents are most satisfied with include security of tenure (30%), housing quality (18%) and community security (17%). The aspects that tenants felt least satisfied with include rent rate (3%), convenience for the work place (4%) and layout and design (6%).

Because there is very limited security of tenure in the private rental housing market in China (Man 2011), PRH has strong attractions for the middle class who highly value residential stability. Further, the high ratio of housing satisfaction among PRH tenants can be also attributed to the fact that the PRH projects are "gated communities". Wu (2005) suggests that the primary reason for the new emergence of gated communities is more about the protection of life style and the self-identity of the middle class, it also occurs in the context 'wherein the local government fails to provide differentiated services to those who are better-off in the market transition'. In this respect, PRH provides an alternative to homeownership with an affordable and guaranteed leasing contract offering decent housing to the newly-emerged middle class.

However, the survey also identifies several challenging issues for the PRH programme in Shanghai. For example, about half of respondents complained that the rent is too high in their survey questionnaires. Taking the ratio of rent-to-income of 0.3 as a threshold of housing affordability, the survey shows that about 25% of respondents could not afford the rent of PRH. In addition, PRH tenants bear other additional

[10] http://www.shgjj.com/html/zyxw/52866.html

[11] For example, at the end of 2012, the occupancy ratio of Xinning Apartment was only 30%; ShangjingYuan Garden's occupancy rate was much better, around 72%, largely due to a large rental demand from employees of universities and research institutes around it.

costs. More than half of respondents (51.52%) reported that their commuting time from home to work increased in comparison to their previous residence; 90% of respondents needing to spend more than half an hour to go to workplace after moving into the PRH projects (in contrast to only 57% before moving in).

Field work also shows that the two PRH projects are located in areas with limited job opportunities and the access to the subway and other mass means of transport is not good. It is clear that besides the high rent level, the low occupancy rate of PRH projects can be also attributed to their disadvantages in terms of location. The latter however is a common problem experienced in the history of public housing development in western countries (Green and Malpezzi 2003). To save investment costs, municipalities worldwide tend to place newly-built public housing projects in areas where land is less valued. Such a strategy however makes these projects unattractive to working households.

Meanwhile, although the large-scale construction of PRH projects can be justified on cost-reduction grounds (economics of scale), we argue that it should be carefully avoided. It is difficult to attract a large pool of applicants for any one given community. Instead, we recommend scattering small-size PRH projects across mature urban areas with good transport connections. We also believe it is cost-ineffective to provide all PRH through new construction and we support purchasing or adapting old vacant properties to be used as PRH apartments. Further, a selective rent subsidy policy should be implemented by the municipality to lessen the affordability burden of PRH tenants and increase the attractions of PRH among low income households.

5. Conclusion

The provision of affordable housing has become a political task in China to alleviate the level of inequality and income disparity generated by market and growth-led development in the post-reform era. Public housing policy, as a primary urban policy, is expected to achieve the socio-economic equality by providing decent homes for all (K. Li 2011). This paper uses Shanghai as case study to elaborate the multiple purposes behind the public housing programmes in China. A close examination of the two key public housing programmes, namely the relocation housing and Public Rental Housing [PRH], has proved that the recent revival of public housing in Chinese cities is mostly driven by economic growth motives.

The supply of relocation housing is coupled with the demand for land as a revenue generator; the inner city redevelopment, the economic restructuring, the mega events and flagship projects to market the city. The PRH programme is one measure of city marketing in order to attract the talented class and involves the development of gated communities for the middle classes. In particular, the existing PRH projects help alleviate the pressure of homeownership for the 'young white collars' by providing a decent place to live at a price they can afford. These PRH projects resemble a temporary substitute for the homeownership of gated communities that the middle class long for. According to our survey, the PRH residents are mainly the young middle class with a high education level, a group which highly values the amenities and the privatized landscape of the gated neighborhoods with high a level of security.

However, the rents of PRH are beyond the affordability range of low-income households. With the rent level close to the market price and other conditions, PRH is a very selective programme with a clear target to attract and keep the 'talented class' to enhance the city's competiveness. Nonetheless, more considerations of low-income households' housing difficulties should be given if the housing policy's long-term aim is to provide decent housing for all. Further, currently the cost efficiency issue seems to be given very little attention in the PRH programme. There is a serious shortage of funding sources for the construction and management of PRH projects. The designs and locations of PRH projects remain hurdles to attracting tenants.

Finally, although the PRH projects in Shanghai are still at an early stage, we believe further investigations of PRH development in Shanghai can produce many valuable policy lessons for other major cities.

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Mortgage practice in Egypt

By Mona M.T. Mostafa

1. Introduction

The housing shortage in Egypt is not only evident in the lack of the required units to house the population, but also in the poor *affordability* of units. This is due to the lack of an efficient home financing mechanism. While some developers offer instalment payment plans, it is not enough. Also, most private developers were attracted to the high-end real estate boom of the 1980s (Loza 2004) creating an undersupply of affordable housing as well as a mismatch between supply and demand. Compared to other North African countries, Egypt has the lowest rate of owner-occupied property and the highest ratio of households in informal housing (Carleton, P., Everhart, S., & Heybey, B. 2006).

Since the adoption of the Mortgage Law in 2001[1], the housing sector has been open to mortgage finance. However, mortgages are not yet widespread in Egypt, despite the dire need of the housing sector for a financing mechanism. Research by Stephen Butler (University of Chicago), Mariya Kravkova (International Finance Corporation) and Mehnaz Safavian (The World Bank) has indicated that mortgage financing amounts to less than 1% of GDP in Egypt while it stands at 10% of GDP in Mexico, 39% of GDP in South Africa and more than 85% of GDP in New Zealand (Butler, Kravkova and Safavian, 2009).

The Central Bank of Egypt [CBE] strictly regulates banks, which are the primary lenders. Most real estate lending goes to developers, who are on the supply side, rather than to purchasers, on the demand side (Regulatory agency officer. Personal Communication, 2012).

The findings presented here are from a longer work of research, titled T*he Mortgage Market in Egypt: barriers and recommendations to availability of housing finance*, which examines why mortgage finance is not performing better in Egypt, even though the housing sector is in need of an efficient finance mechanism. It addresses problems within the market, its policies and structure, and provides recommendations to develop a better performing mortgage market.

2. Methodology

Primary research was conducted through personal interviews with mortgage experts and market players, composed of regulators and prominent lenders, including:

2.1. Regulators

- The Central Bank of Egypt [CBE] is an autonomous public legal body that is responsible for, among many objectives: realizing price stability and the soundness of the banking sector, setting and implementing the country's monetary policy, setting and implementing banking policies, managing liquidity in the economy, and supervising operations of banks in Egypt.
- The Egyptian Financial Supervisory Authority [EFSA] is the result of a 2009 merger between agencies that supervised and regulated non-banking financial markets; specifically: the Capital Market, the Exchange, all activities related to insurance services, mortgage finance, financial leasing, factoring and securitization. In relation to mortgage finance, EFSA came to replace the Mortgage Finance Authority. EFSA's training arm is the Institute of Financial Services, which offers mortgage training for EFSA employees as employees of the mortgage market.
- The Egyptian Banking Institute [EBI] is the training arm of the CBE.

2.2. Mortgage lenders

- Tamweel
- Ahli United Finance
- Tayseer
- Nationale Société Générale Bank [NSGB]
- Alexbank
- Taamir[2]

[1] In 2001, the Mortgage Finance Authority [MFA] was created by presidential decree to stimulate and regulate mortgage lending by lenders other than commercial banks (Struyk 2007). This led to the Real Estate Finance Law of the same year, which contains a strict definition of the loan instrument, specified to be a three-party agreement between the buyer, the lender, and the seller of a property (Struyk and Brown 2006). Everhart, Heybey and Carleton closely examine the 2001 Mortgage Law, which was not implemented until 2004. Its initial goal was to enable borrowers to make a 20% down payment and pay installments for the duration of 20 to 30 years. Under the law, buyers would receive titles and lenders would be able to foreclose on a property in case of default for six to nine months. It is modeled after US mortgage regulations. It allows financing from bank and non-bank lenders but the two are regulated differently. Non-bank lenders operate similarly to banks but are not limited by strict regulations and lending percentages (Carleton, P. Everhart, S. & Heybey, B. 2006).

[2] Taamir was the first specialized mortgage company formed under Law 148. It is owned by a consortium of public organizations, including the Ministry of Housing, the Housing and Development Bank, Misr Insurance, National Investment Bank, and Misr Life Insurance. Taamir is one of the very few companies that have almost reached their maximum licensed capital of LE500 million, standing now at LE425 million. It also has the largest market share of all lenders, including banks, with over 22,000 clients. Of the current outstanding loans, about 85% are out to low-income borrowers, also setting Taamir apart from other mortgage companies. Taamir is the only mortgage lender that finances construction, providing it is being done by the end user and not by a developer.

- The National Bank of Abu Dhabi [NBAD]
- The Commercial International Bank [CIB]
- The Egyptian Mortgage Refinance Company [EMRC][3]
- The Egyptian Housing Finance Company [EHFC]

2.3. Real estate developers

- Talaat Mostafa Group [TMG]

2.4 Research limitations

- Confidentiality was a primary limitation to the lenders' interviews. Some findings remain anonymous or are not traced back to a specific institution, as per the request of some interviewees on specific pieces of information.
- Access to market players: mortgage lenders were most eager to participate and real estate developers were the most difficult to persuade to participate. Only one real estate developer is cited.
- Some types of market players in the mortgage market were left out of the research, including mortgage borrowers and some legal entities, such as notaries and involved ministries.

3. Findings

There are three types of mortgage lenders in Egypt: specialized mortgage companies, specialized banks, and trade banks. Specialized mortgage companies are regulated by the Egyptian Financial Supervisory Authority [EFSA] and both types of banks are regulated by the Central Bank of Egypt [CBE]. (Bank officer)

Banks' attention to mortgages gradually increased after the implementation of the mortgage law. They started to respond to the real estate market boom by 2005, labeling the mortgage market as an "unexplored diamond" (Bank officer). Among the reasons mortgages are attractive to banks is because they make the client stay with the bank, or the lender, for at least ten to fifteen years.

3.1 Regulations

Lending related to housing and construction is divided into real estate, which is lending for corporations, and mortgages, which involves lending to individuals. While specialized mortgage companies are regulated by EFSA, there is also indirect regulation from the CBE. According to a senior officer at EHFC, since companies are borrowers from banks, so CBE regulations affect bank policies, which consequently affect borrower mortgage companies.

There are two regulations issued by the CBE concerning mortgage lending. First, there is a 5% ceiling of the banks' loan portfolio on real estate lending. Second, provision for real estate lending is at 50% of the unit value, as opposed to 25% in other sectors.

The practice of provision serves to decrease risk of non-performing loans or default and it is similar in concept to capital requirements but differs in practice. For example, if a bank makes a mortgage loan of 70% of a one million pound unit (LE 700,000) it would have to set aside LE 500,000. This amount is deducted from the bank's capital and returned when the borrower completes the mortgage installments. In the case of payment default, the lending bank must set extra provision on the remaining amount of the loan (in the example, there is a difference of LE 200,000 between the loan amount and the amount in provision). Provision is only for the bank's books, it is an internal process but is reported to the CBE (Regulatory agency officer).

The 5% ceiling is there due to risks associated with long-term loans, including maturity mismatch and repayment default. As a solution, some banks have developed specialized mortgage companies that lend out of their own capital or through loans from other lending institutions (Regulatory agency officer). Other banks overcome the regulation through securitization (Bank officer).

Another guiding principal by the CBE is the debt burden ratio [DBR], which is the percentage of a borrower's income that can be debt. The average DBR for which banks give loans is 35%. For example, if a borrower makes LE10,000 a month, and pays total instalments for a car loan and a personal loan of LE2000, and the 35% DBR is applied, then the borrower has a maximum left over of LE1500 to take a mortgage, or to take on another type of banking debt (Regulatory agency officer).

The mortgage law was first amended in 2004 to create more flexibility within the market; instead of only allowing mortgages for registered units, units that were eligible for registration could also be mortgaged. Registered units are properties, both land and buildings, that are recorded with the Egyptian Ministry of Justice registration offices. Registration of property serves as a historical database of ownership of properties. It allows the government to keep track of private and public properties, as well as to guarantee

Table A. Mortgage market: Important details and indicators

Indicator	Cumulative – September 2010	Cumulative – September 2011	Growth[4](%)
Total mortgage lending by mortgage companies (in millions, EGP)	1,961	2,808.9	43.2%
Total outstanding debt by investors to mortgage companies (in millions, EGP)	1,381	1,889	36.8%
Total mortgage lending by banks (in millions, EGP)	2,160	2,600	20.4%
Total number of borrowers	16,298	24,876	52.6%
Average loan to value ratio (LTV) %	48.1%	45.6%	5.2%
Average Interest Rate (%)	12.5%	12.3%	-1.5%
Average loan amount (in thousands, EGP)	120.4	112.9	-6.2%
Average repayment duration (year)	16.1	16.4	1.9%
Average monthly installment (EGP)	2,983	2,737	-8.2%

Source: Egyptian Financial Supervisory Authority Quarterly Report July-September 2011. www.efsa.gov.eg

[3] EMRC is the only specialized mortgage refinancer in Egypt. EMRC is owned by a consortium of public institutions and banks, including: the Central Bank of Egypt, National Bank of Egypt, Mortgage Finance Guarantee and Subsidy Fund, Arab Bank, HSBC, Societe Arabe Internationale de Banque, BNP Paribas, Commercial International Bank, Faisal Islamic Bank, Banque Misr, Al Watany Bank of Egypt, Taamir Mortgage Finance, Misr Iran Bank, Egyptian Gulf Bank, Housing and Development Bank, Ahli United Bank, Egypt Arab Land Bank, Tamweel Mortgage Finance Company, International Finance Corporation, United Bank.

[4] Growth: Percentage increase from September 2010 (first column) to September 2011 (second column)

ownership rights to individuals. In 2008, there was another amendment to mortgage regulations. Not only did the mortgage unit have to be registered or eligible for registration, it also had to have completed utilities, specifically water and electricity. This regulation was only for banks. Companies could still finance units under construction but the amount of finance had to be equal in ratio to the percentage of construction completed, and only for a specific amount of their portfolio, approximately 30%. (Bank officer).

3.2 Current market data

According to the third quarter 2011 EFSA report, the volume of the mortgage market stood at approximately LE5.4 billion, divided almost equally between banks and specialized mortgage companies, as shown in Table A.

Table B shows that over 66% of mortgage lending is made to low-income clients, with a monthly income of LE1,750 or less. While the largest market base is low-income groups, Table C shows that the highest value of mortgage loans is made to high-income groups.

Table B. Borrowers by monthly income

Monthly income (EGP)	Cumulative – September 2010		Cumulative- September 2011		Percentage change[5]
	Number	Share	Number	Share	
Up to 1750	10,875	66.7%	17,118	68.8%	57.4%
1751-2500	1,011	6.2%	1,321	5.3%	30.7%
2501-5000	1,321	8.1%	1,781	7.2%	34.8%
5001-10000	604	3.7%	858	3.4%	42.1%
10001-20000	709	4.4%	1,064	4.3%	50.1%
20001-100000	1,250	7.7%	1,924	7.7%	53.9%
More than 100000	528	3.2%	810	3.3%	53.4%
TOTAL	16,298	100%	24,876	100%	52.6%

Source: Egyptian Financial Supervisory Authority Quarterly Report July-September 2011. www.efsa.gov.eg

Table C. Volume of mortgage lending by monthly income of borrowers

Monthly income (EGP)	Cumulative – September 2010		Cumulative- September 2011		Percentage change[6]
	Amount (million EGP)	Share	Amount (million EGP)	Share	
Up to 1750	365	18.6%	555.9	19.8%	52.3%
1751-2500	57	2.9%	73.4	2.6%	28.8%
2501-5000	102	5.2%	134.1	4.8%	31.5%
5001-10000	84	4.3%	102	3.6	21.4%
10001-20000	142	7.2%	175.3	6.3%	23.5%
20001-100000	543	27.7%	804.3	28.6%	48.1%
More than 100000	668	34.1%	963.9	34.3%	44.3%
TOTAL	1,961	100%	2,808.9	100%	43.2%

Source: Egyptian Financial Supervisory Authority Quarterly Report July-September 2011. www.efsa.gov.eg

3.3 Common market practices

Most lending is made on a decreasing interest basis; interest is calculated according to the outstanding balance remaining with each payment. Therefore, as the debt is being paid off, interest is charged on a progressively smaller amount. So while the initial interest rate may seem high, the actual interest amount paid decreases over the years of loan repayment.

Many mortgage companies practice transfer of mortgage portfolios. This is a process by which a mortgage company buys off all the outstanding installments in a developer's portfolio. The first lender's (the developer's) clients become the clients of the mortgage company, and are notified through a legal notification of transfer (Mortgage company officer). The mortgage lender benefits from the interest charged and the developer benefits by receiving full and final payment from the portfolio buyer rather than payment through a trickle of buyer installments. Refinancing through the Egyptian Mortgage Refinance Company [EMRC] is possible but not mandatory.

Most mortgage lenders, whether specialized mortgage companies or banks, require borrowers to submit post-dated cheques with the repayment amounts and according to the agreed upon repayment plan. On one hand, mortgage lenders are borrowers from banks, so the cheques collected from clients serve as the company's borrowing collateral and mode of payment (Mortgage company officer). On the other hand, the cheques are not only used as a repayment method, but also as a pressure tool. Default on a cheque is considered a misdemeanor case by the courts, while foreclosure follows a more lenient path in court. For lower income borrowers who do not have the capacity to write cheques, lenders may take trust receipts[7] (Mortgage company officer). The idea of going to court scares lower income borrowers, who realize the risk of jail and seizure of assets that may result from passing non-performing cheques or trust receipts.

In the case of the lender reclaiming the unit in question in case of borrower default, the unit is either sold through an auction or added to the lender's assets. To avoid the process of foreclosure, which is discussed in later sections, some clients may ask for special payment schemes, such as rescheduling payments to prevent default. This is beneficial for the lenders as they are still making money from repayments, just under a different arrangement (Mortgage company officer).

3.4 Common issues

3.4.1 Security

All lenders interviewed provide mandatory life insurance with mortgage loans, in case of

[5] Growth: Percentage increase from September 2010 (first column) to September 2011 (second column)

[6] Growth: Percentage increase from September 2010 (first column) to September 2011 (second column)

[7] A trust receipt is a document signed by a borrower and given to the lender stating the owed amount. It can be used in courts as leverage on payment default.

death or permanent disability of the borrower, to ensure payment continues. The mortgage law specifies that the borrower cannot be above sixty-five years of age at the end of the term (Mortgage company officer). Also, some lenders practice what is called bridging collateral, meaning they do not take the mortgaged unit as collateral, but some other unit or capital owned by the borrower (Bank officer).

3.4.2 Credit rating

Methods of credit evaluation are separated into the Commercial Credit Registry for corporations and the I-Score for individuals (Regulatory agency officer). Before the I-Score, lenders relied on CBE reports to assess borrower credit rating, but CBE reports did not provide a detailed history. Borrowers with poor credit rating are placed on the CBE's 'negative list' and lenders are prohibited from lending to those on the negative list (Regulatory agency officer). "The credit bureau is the bible," but further credit evaluation is carried out even after the credit bureau green light (Bank officer).

A CBE official claims, "Everything is rated by the CBE in some way. For example, an individual working for a multinational corporation is rated higher than another working for a no-name company." Ratings are also determined by income, years of work, and residence. Residence is an especially unique rating because some residential areas are labeled as 'negative areas' to denote lower income areas (Regulatory agency officer).

3.4.3 Low income housing finance

Low-income mortgages can be co-financed with the Mortgage Finance Guarantee and Subsidy Fund, which is the government arm to promote and assist in mortgage finance (Mortgage company officer). By law, installments for low-income borrowers cannot be more than 25% of their income. Low-income is defined as a maximum monthly income of LE1750 for singles and LE2500 for families (Mortgage company officer).

3.4.4 Mortgage finance and developer installment plans

An alternative home purchasing method is through developer installment payment plans. One point that might make clients favor developers is that developers do not rate clients like mortgage lenders do (Mortgage company officer). When it comes to repayment default, there are more ways to pressure a client in default with developer installments than with mortgage repayments. For example a developer can cut off water and electricity to a specific unit, but a mortgage lender has no such control (Real-estate developer officer).

4. Problems and barriers

4.1 Infrastructure: documentation and registration

Property registration is the single agreed upon barrier to mortgage finance within the scope of this research. Registration is a significant issue for mortgage finance because the mortgage law specifies that only units that are registered or eligible for registration can be financed but only about ten percent of all real estate property in Egypt is registered. 60 to 70% of the processing effort of mortgage lending is legal documentation. 90% of the urban real estate market remains unregistered despite the amendment of registration laws and regulations (Mortgage company officer). Registration is further important to mortgage finance as it is the gateway to collateral and guarantee for the mortgage (Regulatory agency officer).

Problems specific to registration can be summed up as the time it takes to register a unit, the complexity of the process, and the cost. The length of time it takes to process a mortgage is not due to the banks, rather on part of the regulators, especially the notaries (Bank officer).

One mortgage lender claims that the problem with registration is not just in the paperwork, but people were not registering their property to avoid consequent and associated taxes and fees (Bank officer). Also, there is no incentive for developers to register their land and individual registration fees remain high. The announced flat rate of maximum LE2000 for registration is not the reality. There are other associated fees, up to LE5000 in legal fees, not to mention what is still being paid under the table (Mortgage company officer).

4.2 Deposits, loans, and maturity mismatch

Another problem that was brought up in most interviews is the maturity mismatch between deposits and loans. Lenders very much realize that there is a problem with mortgages in that short-term deposits fund long-term loans (Bank officer). Banks find their funds either from depositors or investment projects, both of which do not work well given the long-terms of mortgages. With other forms of bank loans, ten years is considered long term but the mortgage market is different (Mortgage company officer), because mortgage lending is for a longer term.

4.3 Lack of information: mortgage concept and data

Even to banks, the concept of a mortgage is still very new and its process is not yet well known (Bank officer). Mortgage professionals do not always understand the product either, and thus cannot sell it (Mortgage company officer).

Not only is the concept not clear, but neither are its components. For example, interest rate as a concept is one of the barriers to more widespread mortgage finance. With interest, people think they are paying more unnecessarily. "It is in the Egyptian culture to want to profit without allowing others to profit, but it is, or is supposed to be, a mutual benefit relationship," claims one marketing specialist at Tamweel Mortgage Finance.

Since notaries do not understand mortgages either, there are constant requests for the buyer and seller to keep coming back for more information as needed by notaries, which becomes a hassle.

Another aspect of information that is lacking in mortgage lending is proof of income. Some lenders argue that proof of income is difficult to determine accurately because Egyptians tend to avoid taxes, so a lot of activity goes unrecorded (Bank officer).

When it comes to mortgage data and the volume of the market, there are more inaccuracies. EFSA numbers are not accurate as a result of duplication. For example, if a mortgage company makes out a loan that it refinances through a bank, that same loan is counted twice and thus increases the overall volume of mortgage lending (Mortgage company officer).

4.4 Mortgage training and education calibre

Some market players claim openly that there is a lack of good calibre mortgage professionals. There is a need for people who can sell them from a technical point of view and who can simplify them for the client. One prominent lender claims that not only are the lending professionals lacking in their knowledge of mortgage lending mechanisms, partly due to their limited experience within a relatively new mortgage market, but also the regulators' employees are often not knowledgeable enough themselves to properly review the work of mortgage professionals. Even courses offered by the EBI have been described as too theoretical (Bank officer).

4.5 Cost of mortgage

Not only are the interest rates high, but there are many other associated fees such as administrative and notary fees, and these associated fees push mortgages further out of the reach of those who may need them most (Regulatory agency officer). Prices of components of real estate, such as steel and land, have increased, and are burdens on the end user (Mortgage company officer).

Currently, most lenders provide mortgages at a decreasing interest rate of about 14% on average, as previously explained. It is not only inflation associated with high interest rates, but also the high cost of money in Egypt. For example, treasury bills are priced at 16%, so the lending rate should be even higher than that since lenders make their profit from the interest rate spread (Mortgage company officer).

High costs associated with the mortgage process, including registration fees and high interest rates, also drive lenders away from promoting mortgages as much as they would. High provision that increases with payment delays is a burden on banks that increases as their loan portfolios grow (Bank officer).

One lender claims that there is not much hope for mortgages as a retail product. It is the least selling retail product, compared to credit cards and car loans, which are more profitable to banks (Bank officer).

4.6 Foreclosure and courts

Lenders move to foreclosure procedures only after the borrower in default is unresponsive and unwilling to repay the remaining amount of a mortgage loan. It is not to the benefit of the lender to move to foreclosure and even to reclaim a unit, but lenders do so when they do not have another choice. Lenders are financial institutions, not real estate sellers and buyers. It is in their best interest that a borrower continues payments according to schedule (Mortgage company officer).

Foreclosure is problematic due to its long process, up to a year on average, and the associated costs. There have only been four or five foreclosure cases in the entire mortgage market since the law was implemented (Mortgage company officer).

Other than a ban of the sale of the unit in question, the bank really has no control over foreclosure. Court cases can take years. It is a hassle that drives the bank further away from mortgage lending (Bank officer). Even though lenders collect post-dated cheques worth the repayment amount, these cheques are a tool to exert pressure but no good as collateral. The lender does not want a legal case against the borrower, it is to the benefit of the lender for payments to continue; there is no gain by sending a borrower to prison because of unpaid debts, the debts remain unpaid (Bank officer).

4.7 Mortgage culture

Mortgage repayment and rent payments are often compared, as both methods of payment for housing are in the form of installments rather than a lump sum. Some lenders claim that borrowers, and potential borrowers, do not always understand the core difference between rent and mortgage: with rent, payments are made over years and the only benefit the renter has is occupation of the unit; with mortgage repayment, the borrower has right of occupation and also ownership of the unit. Lenders attempt to explain that mortgages are an investment to borrowers who have difficulty understanding such long-term investment that seems so similar to rent (Mortgage company officer).

4.8 No leader

The mortgage market in Egypt has been described as a "fatherless child" (Mortgage company officer). In other words, there is no patron for mortgages, be it a person or an organization or even a single model to follow. There are too many parties involved in the mortgage process, including but not limited to:

- The Ministry of Housing [MoH] manages and initially sells properties initially to individuals and investors. In new areas outside of city centers, MoH operates through the New Urban Communities Authority [NUCA], an agency of MoH.
- Governorate offices have authority on land use, including licensing for activities within their jurisdiction.
- Space Surveys, which defines in detail the land and unit dimensions of a property, and is an agency under the Ministry of Irrigation.
- Lending is managed through the financial sector, through banks and companies and regulated by the CBE and EFSA.
- Property and registration are under the Ministry of Justice through notary publics.

All the previously listed are involved parties but none has overall responsibility for the mortgage market as a whole. (Mortgage company officer). All parties involved including the Ministry of Housing and the Ministry of Justice want to be the owner. Therefore, they are consistently obstructing each other's work. There is no collaboration and no synchronization.

4.9 Limited securitization

A major problem with the mortgage market, at least for lenders, is that the mortgage process stops at a critical stage, which is securitization. Securitization is the bundling and sale of mortgages to the secondary market (Real-estate developer officer). In Egypt, there is only one mortgage refinancer. In active mortgage markets, there are many more refinancers, including mortgage brokers. The role of the refinancer should be to gather mortgages from different originators, bundle and securitize them and release bonds for their value. Secondary markets are important because investors have the liquidity to keep the mortgage market active, and their bonds are secured by the mortgages (Mortgage company officer).

5. Recommendations

Recommendations for achieving a better performing mortgage market were made by mortgage market players, consisting of regulators, lenders, and developers. These recommendations only represent opinions of market players included in the research and not the researcher's. Recommendations included, but were not limited to, the following:

5.1 Awareness and education

Many lenders agree that collective mortgage awareness is long overdue. One mortgage company is experimenting with the possibility of a national mortgage awareness campaign, but it is still at the idea phase (Mortgage company officer). The Egyptian Banking Institute [EBI] is a provider of mortgage training and coursework, and also realizes the lack in awareness. They claim that, at least in the short term, mortgage awareness campaigns should target those with the capacity to use banking services, including income transfer for savings and borrowing, among other services. Nevertheless, the awareness has to start at school. (Regulatory agency officer). This would include some education about the financial market and its different instruments so students are brought up with some understanding and not complete obliviousness to finance.

5.2 Areas of work on the part the government, including mortgage market regulators

Many lenders realize that property valuation is problematic and some recommend that the government must change the infrastructure related to appraisers, particularly the space surveys authority which is, very much inconveniently, under the Ministry of Irrigation (Mortgage company officer). Another lender recommends the privatization of space surveys, which would be more dedicated and efficient (Mortgage company officer). Another lender claims that the restructuring of mortgage-related institutional infrastructure is so vital that one recommendation is to start over. An official at one mortgage-lending bank suggests that, "Fixing the mortgage situation must start with infrastructure. Do this first for five years then look at mortgages." This particular recommendation implies a complete start-over for mortgages, using the current market experience with all of its problem areas to create a stronger market foundation.

Several lenders made recommendations specific to the role of EFSA. EFSA should help facilitate the mortgage procedure. It must become more advanced as an authority of the government. For example, EFSA insists on lenders using specific, outdated forms instead of programs like Microsoft Excel (Mortgage company officer). Other lenders agree that instead of constantly tightening controls on lenders, EFSA should market the mortgage product (Bank officer). One suggestion for promoting mortgages is the consideration of tax exemptions for employees who have taken a mortgage (Mortgage company officer). Lobbying for such a policy change can best be achieved through the efforts of a regulator of the mortgage market.

With regard to legislation, specifically Law 148, some lenders claim that it must be revisited and changed to match the reality of the housing market. Moreover, regulators should consider the period since the implementation of the law a trial period and listen to lenders for feedback on that period (Bank officer).

5.3 Areas of work on the part of lenders and mortgage professionals

Since mortgages in Egypt are tailored and case-specific, it is very important for mortgage professionals to have stronger grasp of the legal background. A legal background is important due to the dependence of mortgages on legal documentation (Mortgage company officer).

Another recommendation is that, collectively, the lenders need to standardize documentation and improve overall service quality to be more user-friendly; and being more user-friendly is a result of standardized documents and an improved service quality. "We need to all stand on the same side," claims Hala Bassiouny of EHFC, and standing on the same side starts with standardizing documents (Mortgage company officer).

As a regulator, EFSA has more suggestions for lenders. It believes that the mortgage product should be improved to fit most potential borrowers. This includes the reduction of fees and the service being made smoother. Lenders should participate in policy change along with EFSA as they are the ones in the market and know it better (Regulatory agency officer). However, in its criticism of the high cost of mortgages, EFSA does not note that a lot of mortgage-associated fees are not charged by lenders, but rather as a cost of legal fees. And while EFSA claims that lenders should participate in policy change, none of the lenders participating in this research noted that EFSA lends a listening ear.

5.4 Synchronization

Synchronization must occur at different levels. First, there must be synchronization between authorities. Lenders are a tool in the mortgage market, and not the creator. New, harmonious policies must be implemented (Bank officer). It is important that the market must be seen in a synchronized view from the top. Synchronization does not necessarily mean centralization. For example, even if the mortgage market is never centralized, there should be, at least, specialized mortgage notaries (Mortgage company officer).

5.5 Other recommendations

- One professional recommends the Egyptian mortgage market adopting the Canadian mortgage model. This includes establishing a national agency for mortgage finance to undertake the responsibility of implementing a national plan. This agency should have an executive role, as in to have the capacity and authority to fully execute its plan (Mortgage company officer).
- One particularly interesting recommendation for the mortgage market was a suggestion to resort to a different type of financing altogether, specifically, the adoption of Islamic banking for mortgages. Islamic mortgages, because of rent-based schemes, would allow the market to skip most of the processing effort in legal work (Bank officer).

6. Research implications and conclusion

The above findings and recommendations represent opinions and suggestions of market players included in the research based on their professional experience. Further examination of the mortgage market is required to assess the pertinence of those findings and recommendations.

Most, if not all of, the barriers cited by the experts and prominent players in the market imply a degree of institutional immaturity in the Egyptian mortgage market. Barriers, including lack of synchronization, lack of a secondary market, lack of leadership, and difficulty in the foreclosure process are all signs of an institution that is not yet fully developed, or immature.

This research demonstrates the importance of listening to players from within the market. Collectively, there seem to be some very solid ideas about how to take the mortgage market forward. It is important that the experience of these players is utilized in policy change. Actors cannot be blamed for lack of adequate performance in an unsuitable environment. Successful policy must be made to change the status quo.

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Appendix 1 - Institutional Interviews

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Mortgage guarantee: a concept paper

By Vibha Batra and Kalpesh Gada

1. Introduction

The INR (Rupees) 8.2 Trillion (as on September 30, 2013) Indian mortgage market is funded primarily by traditional products, given that funding by the secondary mortgage market is insignificant. Further, there are no economical options available for credit risk transfer or for external credit enhancement—a situation that forces originators (or lenders) to rely on equity as the sole source of core Tier I capital or for credit enhancements. Such reliance on equity could hamper lenders' growth prospects or lead to overleveraging when capital market conditions are not conducive. Access to external equity could also remain limited for long periods if investors are hesitant or promoters unwilling to dilute at low valuations. Since the mortgage market is an important pillar for economic growth, development of alternative equity sources could help mortgage lenders maintain prudent capitalisation levels even in unfavourable market conditions, without having their growth prospects curtailed or compromising on shareholder returns. It is in this context that there is value to be seen in the use of mortgage guarantee [MG] as an important alternative to equity.

In January 2008, the Reserve Bank of India [RBI] came out with guidelines for the mortgage guarantee business. Based on our assessment and analysis, we believe the MG product could be a viable mode of alternate funding for entities in the mortgage finance space.

1.1 Mortgage guarantee

Mortgage Guarantee is also known as mortgage insurance [MI] in global markets. The MG product is designed to offer credit protection to lenders and other benefits outlined below. As per the RBI regulations, if a lender takes a MG protection on a home loan or a pool of home loans, they are partly[1] protected by the Mortgage Guarantee Company [MGC] in the event of a default by the borrower. The lender has the ability to invoke the MG as soon as a product becomes a Non Performing Asset [NPA] as per the RBI norms.

This typically means that from a lender and regulatory perspective, there is an element of risk transfer from the lenders books to the balance sheet of the MGC. As detailed later in this paper, this risk transfer enables the lender to release capital as per the Basel rules resulting in more efficient use of capital and enhanced return on equity [ROE] for shareholders from the same capital base. We would also like to highlight that the benefits from using the product accrue with consistent use and it should not be viewed as an opportunistic/tactical decision but one linked to the long term strategic goals of the lenders. The product can typically take two forms, Top cover and Quota share (described in more detail in the following pages).

Some of the key product benefits detailed in the paper are:

- Relief on regulatory capital adequacy
- Release of economic capital
- Lowering of credit enhancement levels in securitization transactions
- Improvement in return on equity

A mortgage guarantee has been recognised by the RBI as a valid credit risk mitigant [CRM] under para 7.5 of the Master Circular – Prudential Guidelines on Capital Adequacy and Market Discipline Implementation of New Capital Adequacy Framework [NACF]. The product is designed to protect the lender over the long cycle of a mortgage against credit risk due to economic cycles and decline in housing prices.

2. Overview of the product

Lenders can seek a MG cover on their portfolio against payment of a fixed premium, determined at the time of taking the cover. The MGC would apply certain selection criteria and carry out its own due diligence as per the RBI guidelines while underwriting the loans. The RBI guidelines enlist the essential features of a mortgage guarantee contract, which are mentioned in Appendix 1. The MG would cover the principal and interest outstanding on the loan, up to the amount of the guarantee. As per the guidelines, the guarantee can be invoked when the contract becomes a NPA.

The guarantee cover can be taken by the lender at the time of loan origination (typically termed as flow product) or after some seasoning of the underlying loans on the books of the originator (also known as bulk product). The MG is typically structured in the following two forms:

- **Quota share**

Under this product, loss at a contract level is shared on a pro-rata basis between the originator and the MGC. While the MGC provides cover on the defaulted interest amount as well (and not just the principal amount alone), the maximum claim that is borne by the MGC is capped at the agreed extent of MG coverage on the loan (for example, 30%), expressed as a percentage of the loan amount outstanding at the time the contract becomes an NPA on the books of the originator. As

[1] Depending on the type and level of loss share opted for, subject to the loan meeting other conditions specified by MGC.

the loss is split pari-passu between the originator and the MGC, this product results in alignment of interests between the MGC and the originator.

Any loss incurred at a contract level would be shared between the originator and Guarantor on a pro-rata basis (based on the agreed split between the two parties involved), as is illustrated in Table 1.

■ Top cover

Under this product, the MGC would bear the first loss on any contract. While the MGC provides cover on the defaulted interest amount as well (and not just the principal amount alone), the maximum claim to be borne by the MGC would be capped at the agreed extent of MG coverage on the loan (for example, 30%), expressed as a percentage of the loan amount outstanding at the time the contract becomes an NPA on the books of the originator. Only if the total loss on any contract exceeds the extent of MG coverage on the loan, would there be any loss to the originator.

Under the Top Cover product, first loss up to the agreed extent of MG coverage on the loan is borne by the Guarantor. Only the excess loss, if any, is borne by the originator, as is illustrated in Table 2.

Clearly, the extent of credit risk being retained by the originator after taking MG cover on its portfolio depends on the nature of the MG product and the extent of MG cover available from the Guarantor.

The eventual loss borne by the originator reduces significantly during a period of stress (prolonged economic slowdown resulting in widespread job losses/ slowdown in business of the customers, and/ or sharp depreciation in property prices).

With both product options the loss incurred by the originator decreases with an increase in the MG cover available from the Guarantor. For example, under the Quota Share product, if loss at contract level is 40%, loss borne by the originator is 34% with 15% loss cover and only 20% with 50% loss cover. Similarly, the originator benefits more (i.e. incurs lower loss) under the Top Cover product as opposed to the Quota Share product. For example, if loss at contract level is 40% and extent of loss cover available from the guarantor is 30%, loss borne by the originator is 28% under the Quota Share product and only 10% under the Top Cover product.

Table 1: Quota share product

Extent of Loss Cover (A)	15%		30%		50%	
Loss at contract level (B)	20%	40%	20%	40%	20%	40%
Loss borne by the originator (C = B*(1-A))	17%	34%	14%	28%	10%	20%

Table 2: : Top cover product

Extent of Loss Cover (A)	15%		30%		50%	
Loss at contract level (B)	20%	40%	20%	40%	20%	40%
Loss borne by the originator (C = Max (B-A,0))	5%	25%	0%	10%	0%	0%

It must be highlighted here that the above examples do not take into account the interest shortfall that would be met by the MGC (only the principal shortfall is factored into the above illustration). The actual loss that would be booked by the originator may vary slightly depending on the timing of the loan turning into a NPA and the accounting policy of the originator.

3. Benefits of MG product – on balance sheet funding

On one hand, demand for housing in India from the long-term perspective remains robust on account of the following factors:

- Vast and under-penetrated market (Housing credit as a percentage of Gross Domestic Product [GDP] remains low at around 7% as at March 2012) resulting in huge growth potential
- Demographic factors like a young population, increase in nuclear families, rapid urbanisation and increasing clout of middle income segment having significant disposable income
- Easy availability of credit especially in metropolitan cities and tier 1 cities[2]
- Support from the government and regulators, especially in the affordable housing segment
- On the other hand, the housing market in India is currently facing challenges. Some are highlighted below:
  - **a.** High property prices and tough operating environment (high interest rates)
  - **b.** Low fund availability through the organized sector in the rural markets
- MG product can alleviate some of these concerns and fuel the overall growth of the housing loan market in India in the following manner:
  - **a.** Provide capital relief to lenders, capital released can further be deployed in business resulting in higher business volumes and improved profitability; thus, MG would help diversification of sources for high quality equity capital for the originator
  - **b.** Improve the Return on Equity for the originator as the leveraging capacity goes up
  - **c.** Reduce the quantum of credit risk in originator's portfolio (as some proportion of risk would stand transferred to the MGC) and provide greater operational efficiency (through additional layer of checks and balances in the system)
  - **d.** Improve the originator's product offering in terms of higher loan to value (LTV) ratio on the underlying property (for example, an originator may be willing to offer an LTV of 90% on a contract with MG cover as opposed to 80% LTV on a standalone basis), resulting in greater affordability for the buyer (lower equity contribution), thereby stimulating demand
  - **e.** Improved underwriting, as each loan will have to pass the credit screens of the MGC and also the analytics of the MGC would help the originator to understand the portfolio performance better
  - **f.** Data and analytics on probability of default and cure rates on the guaranteed pools could be a useful input for regulators for policy formulation

[2] Various factors as defined by the Government of India and the Regulators define Tier 1. It is primarily dependant on the population and cost of living in the cities. Mumbai, Bangalore, Kolkata and Delhi are considered as Tier 1 cities

g. Provide greater impetus to the securitization market (as the requirement of credit enhancement to be provided by the originator would come down if the underlying loans included in the securitized pool have MG cover, thereby making such transactions more attractive for the originators)

h. Over time this will lead to standardization of practices and processes across the industry if lenders want to use MG as a CRM

Subsequent sections cover analysis on the following in greater detail:

- Capital release (both regulatory as well as economic)
- Capital at system level
- Impact of MG on the economics of securitization transactions
- Improvement in ROE for lenders as a result of capital relief

3.1 Relief on regulatory capital adequacy

The capital adequacy requirement of various lenders and mortgage guarantee companies is given in Table 3. As seen from the table, the capital requirement for banks (especially for Tier I capital) is likely to increase sharply as the Indian Banks adopt Basel III.

Indian mortgage loans attract two different risk weights depending on the sanctioned loan amount and the LTV as given in Table 4. Therefore, capital in relation to the loan extended by a Housing Finance Company [HFC] could vary from as low as 6% (for a less than Rs. 20 lakh loan at 50% LTV) to 9% (for a > Rs. 75 lakh loan).

The risk weight, in the books of the lender, on the portion of loan covered by MG depends on the credit rating of the MGC. For an 'AA' rated MGC the risk weight is 30% and for an 'AAA' rated MGC the risk weight is 20%.

The capital release for various lenders is driven by a combination of the rating of the MGC and the factors in Tables 3 and 4.

An Illustration of the benefit with 75% risk weighted home loans for different lenders is given in Table 6. *Please refer to Appendix 2 for various other scenarios.*

Table 3: Capital requirement & risk weights: quota share product

Entity	Overall Capital Adequacy	Tier I capital Requirement	Risk weights
Banks (Basel II)	9%	6%	50%, 75%
Banks (Basel III)	11.5%	9.5%	50%, 75%
HFCs[3]	12%	8%	50%, 75%
Mortgage Guarantee Company	10%	6%	50%, 75%

Table 4: Risk weights for mortgage loans

	LOAN SIDE		
LTV	**Up to Rs. 20 Lakh**	**Rs. 20 - 75 Lakh**	**More than Rs. 75 lakh**
Less than 75%	50%	50%	75%
75%-80%	50%	50%	Not Allowed
80%-90%	50%	Not allowed	Not Allowed

Table 5: An Illustration of capital release for the following assumptions is given below

Risk weight	**75%**
Tier 1 capital requirement	6%
Guarantee cover	30%
Rating of the MGC	AA

		REQUIRED CAPITAL CALCULATIONS		TIER 1 CAPITAL IN RELATION TO LOAN
A	**Tier 1 capital in relation to loan (Without the Guarantee)**	Risk weight x Tier 1 capital	75% x 6%	**4.5%**
	Tier 1 capital in relation to loan (With the Guarantee)			
B1	Tier 1 capital for guaranteed portion	Guarantee Cover x Risk weight based on credit rating of MGC x Tier 1 capital	30% x 30% x 6%	0.54%
B2	Tier 1 capital for non guaranteed portion	Non guaranteed part x Risk weight x Tier 1 capital	70% x 75% x 6%	3.15%
B= B1+B2	**Total Tier 1 capital in relation to loan**			**3.69%**
C= A-B	**Capital Released**			**0.81%**

Table 6: Capital release for 75% risk weight loans in case MGC is rated 'AA'

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	**Basel III**	
Capital requirement of the originator without MG	0%	4.50%	7.13%	6.00%
Capital requirement of the originator with MG	15%	4.10%	6.48%	5.46%
	30%	3.69%	5.84%	4.92%
	50%	3.15%	4.99%	4.20%
Regulatory Capital Release	15%	0.40%	0.65%	0.54%
	30%	0.81%	1.29%	1.08%
	50%	1.35%	2.14%	1.80%

[3] The circular on change in Risk weight is expected shortly. Typically follows the norms set out by RBI for Banks.

As seen in the table 6:

- Lenders can save significant Tier 1 capital by opting for mortgage guarantee cover; saving could range from 0.4% - 2.1% of Tier 1 capital depending on the regulatory capital requirement and the extent of MG cover taken. For instance, Tier 1 capital saving for a bank (under Basel II, where Tier 1 capital requirement is 4.5%) works out to be 1.35% (4.5%-3.15%) for a 50% MG cover; while that for an HFC is higher at 1.8% (6%-4.2%). Further, typically lenders maintain excess Tier 1 capital (at around 8%-9% instead of the minimum 6%); in such a scenario capital relief would be higher.
- Capital savings increase as the MG cover increases. For instance, for 15% MG cover capital saving is only 0.40% for a bank under Basel II regime, which increases to 1.35% in case that MG cover increases to 50%.
- As core Tier 1 capital requirement under Basel III is higher, saving in capital is higher under Basel III (2.1% for 50% MG cover vs. 1.35% under Basel II). Thus, banks can take MG cover on their portfolio to part meet their large Tier 1 capital requirement under Basel III.

3.2 Release of economic capital

The regulatory capital requirement is a uniform prescription across all lenders. However, assessment of the economic capital requirement for any originator is based on various qualitative and quantitative factors, including the following:

- Comfort of the top management/ promoter group of the company
- Risk appetite of the originator as demonstrated by its target borrower segment, geographical spread, and key underwriting norms and processes followed vis-à-vis other industry peers
- Asset quality and profitability of the business, as demonstrated by past and present performance of originator's portfolio
- Risk control mechanisms/ robustness of Management Information System
- Prevailing operating environment and its likely impact on the originator and its portfolio in the near to medium term
- Rating of the originator

The economic capital requirement for AA rated HFCs is usually seen to vary from 8% - 12%, depending on the factors mentioned above (as opposed to a uniform regulatory Tier 1 capital requirement of 8% for all HFCs). This capital acts to mitigate unexpected losses that may be borne by the originator under a stress situation (e.g. prolonged slowdown witnessed in the operating environment, resulting in job losses and crash in property prices).

Table 7: Possible reduction in economic capital requirement

Nature / extent of MG cover	15%		30%		50%	
Quota Share	20% -30%	40% - 50%	65% - 75%	40%	20%	40%
Top Cover	35% - 45%	65% - 75%	90% -95%	28%	10%	20%

The capital requirement for any originator would understandably be lower in case it takes guarantee cover on its portfolio, as some degree of credit risk in the portfolio underwritten is now being transferred to the MGC. The extent of economic capital release (from the initial level required) would be determined by the following additional factors (other than factors mentioned earlier):

- Nature of MG product – Quota Share or Top Cover
- Extent of loss cover available from MGC
- Extent of portfolio covered by MG product
- Selection norms adopted by MGC for underwriting loans and claim settlement process
- Expected claim acceptance / rejection rate based on experience over time
- Rating of the MGC

In this assessment, for a typical AA category rated originator and MGC, the extent of reduction in economic capital requirement, owing to the MG cover (on the portion of the portfolio underwritten by the MGC alone) may broadly be as per Table 7.

As can be seen from Table 7, for an AA rated originator and MGC, the reduction possible in economic capital requirement may be 65% - 75% for a 30% Top Cover MG product and 40% - 50% for a 30% Quota Share MG product. However, for the same MGC (AA rating), the benefit would be lower for an AAA rated originator. For instance, the reduction possible in economic capital may be 45% - 50% for a 30% Top Cover MG product and 25% - 30% for a 30% Quota Share MG product. Further, the benefit of MG cover on an originator's portfolio would stand reduced and need to be reviewed by the rating agency in case the rating of MGC gets downgraded post the initial assessment. In the event that the rating of the MGC improves to AAA levels the commensurate benefit of the same will be available to the originator on the entire book with MG cover. While those numbers have not been shown in Table 7, the benefits will be higher.

The quantum of capital release actually possible can only be determined after the rating agency carries out a detailed evaluation of the originator's portfolio underwritten by the MGC. Also, the capital release, as highlighted in table 7, is only applicable on the portion of the capital required on account of credit risk (and not pertaining to market risk or operations risk). However, capital required for credit risk is likely to dominate the overall capital requirement, for instance credit risk weighted assets constituted around 85% of total risk weighted assets for Indian Banks as of March 31, 2012. Further, MG cover can also bring down the lender's operational risk, with the portfolio undergoing an additional round of credit underwriting.

Further, as the economic capital requirement for a high investment grade rating (AA to AAA) is significantly higher than the regulatory requirement, sometimes lack of adequate level of economic capital becomes a constraining factor for growth or for the credit profile. In this situation, a lender could release significant economic capital by taking a mortgage guarantee cover, capital thus released could be further leveraged to increase the business volumes or to meet an economic capital deficit or to reduce its cost of funds with an improved credit rating.

4. Capital at system level

System level capital would be a function of the following:

- Risk weight on the home loans
- Risk cover from the MGC
- Credit rating of the MGC
- Regulatory framework

An illustration of capital at the system level (with and without MG) is given in the Table 8 for a 75% risk weight mortgage loan extended by a Bank under Basel II and 30% MG cover obtained from a AA rated MGC.

As seen from Table 8, overall capital at system level increases marginally in the scenario assumed. System level capital would be dependent on the risk weights of the underlying loans.

5. MG as credit enhancement for securitisation/ direct assignment transactions

As per ICRA's[4] estimates, the entire Mortgage Backed Securitisation [MBS] volume of over Rs. 7,500 crore witnessed in India in FY 2012 was constituted by direct assignment [DA] transactions (i.e. bilateral assignment of loan receivables from non-banking finance companies [NBFCs]/HFCs to banks) as opposed to conventional securitisation transactions (assignment of loan receivables to a trust and the trust issuing securities backed by the same). The key objective for the banks to acquire loan pools from NBFCs/ HFCs is to meet their priority sector lending [PSL]) targets, particularly post RBI's Master Circular of July 2011 on priority sector lending, according to which the loans by banks to NBFCs no longer qualify as PSL.

Till FY 2012, RBI guidelines on securitisation transactions were not applicable for DA transactions. This resulted in significant regulatory capital release for the originator, as it had the option to treat credit enhancement at par with its other risk weighted assets while providing the capital.

However, in May 2012 and subsequently in August 2012, RBI came out with a fresh set of guidelines for both securitisation and DA transactions (applicable to Banks and NBFCs respectively) that prohibit credit enhancement from the originator for DA transactions. In the absence of credit enhancement, these transactions require a precise valuation of the underlying loan receivables being assigned (i.e. an estimate of the cash flows actually likely to materialize after taking into account the delinquencies, losses and prepayments in the underlying loan pool) to arrive at the sale / purchase consideration. Such a precise valuation is a challenge and often there is no meeting ground between the buyer and seller on the expected levels of delinquencies/ losses in the pool.

As a result, during FY 2013, to meet PSL targets, investing banks largely preferred the conventional securitisation route (via a trust/ special purpose vehicle [SPV], where credit enhancement from the originator is permitted. However, the deterrents to securitisation transactions are two-fold-high capital charge for the originators and mark-to-market risk associated with investments in securities issued by the trust for the investors. Further, there is still some ambiguity on the impact of the deduction of distribution tax, by the SPV, on tax-paying entities like banks[5], as specified in the Union Budget for FY 2013-14.

As per prevailing RBI guidelines on securitisation transactions, credit enhancement offered by an originator has to be deducted rupee-to-rupee from the capital (50% deduction from Tier 1 capital and 50% deduction from Tier 2 capital). This would result in some increase in regulatory capital requirement for an originator compared to the erstwhile DA transactions. The increase in regulatory capital requirement for a Bank under the Basel II framework for a securitisation transaction (compared to erstwhile DA transaction) is illustrated in Table 9.

As can be seen from Table 9, the extent of capital release is lower for securitisation transactions compared to erstwhile DA transactions.

5.1 MG to reduce requirement of credit enhancement in securitisation transactions and facilitate DA

The benefit of MG cover in an originator's portfolio would show up in securitisation transactions

Table 8: System level Tier 1 capital

		REQUIRED CAPITAL CALCULATIONS		TIER 1 CAPITAL IN RELATION TO LOAN
A	**Tier 1 capital in the books of mortgage guarantee company**	Guaranteed part x Risk weight x Tier 1 capital	**30% x 75% x 6%**	**1.35%**
B	**Tier 1 Capital in the books of the lender**			
B1	Tier 1 capital for guaranteed portion	Guaranteed part x Risk weight based on credit rating of MGC x Tier 1 capital	30% x 30% x 6%	0.54%
B2	Tier 1 capital for non guaranteed portion	Non guaranteed part x Risk weight x Tier 1 capital	70% x 75% x 6%	3.15%
B= B1+B2	**Total Tier 1 capital in relation to loan**			**3.69%**
C = A+B	**Total Tier 1 capital at system level with MG**			**5.04%**
	Total Tier 1 capital at system level without MG		**75% x 6%**	**4.5%**

Table 9: Regulatory Tier 1 capital requirement for banks under Basel II framework for securitisation and erstwhile DA transactions (assuming 75% RW)

	Erstwhile DA Transaction	Securitisation Transaction
Principal amount securitised/ assigned	100	100
Credit enhancement stipulated[6]	10	10
Capital required by originator had the pool not been securitised[7]	4.5	4.5
Capital required by post securitisation/ assignment	0.6[8]	4.5[9]
Extent of regulatory capital release for the originator	3.9	0

[4] ICRA Limited - A rating agency of repute in India, an associate of Moody's Investors Service

[5] Tax is to be levied at the time of distribution of income by a securitisation trust and distributed income received by the investor is then exempt from tax. Nevertheless, in the case of banks, if the expenses incurred in respect of such investment are not permitted to be deducted–given that the income received is exempt from tax–it would be a negative.

[6] Assumed to be entirely First Loss Facility

[7] Assuming 75% Risk weight

[8] Assuming 75% Risk weight on the extent of credit enhancement provided by the originator

[9] 50% of credit enhancement gets deducted from Tier 1 capital and balance 50% gets deducted from Tier 2 Capital; capital required in respect of credit enhancement is capped to the amount of capital that the Bank would have been required to hold for the full value of the assets, had the assets not been securitised (as per Feb 06 securitisation guidelines)

(in terms of a lower credit enhancement requirement than what would have been required in the absence of MG cover for a similar target rating), provided such contracts are included in the securitised pool. The actual reduction in credit enhancement would depend on the underlying transaction structure, target rating of the transaction and detailed analysis of the originator's portfolio and specific pool to be rated by the rating agency.

As a broad benchmark, for a target rating of AAA, and assuming a "par" securitisation transaction in which residual excess collections (after meeting scheduled investor payouts) are paid out to the originator on each payout date, the extent of reduction in credit enhancement may broadly be in the region of 45% - 50% for 30% Top Cover MG product and 25% - 30% for 30% Quota Share MG product.

The corresponding reduction in regulatory Tier 1 capital requirement for banks under Basel II framework (assuming 75% risk weight for assets being securitised) for a typical AAA rated mortgage loan securitisation transaction can be as per Table 10.

Nonetheless, it must be highlighted that the extent of reduction in credit enhancement could be lower if the credit enhancement is low in absolute terms, to cover the liquidity risk in the transaction (i.e. to mitigate against interim delinquencies in the pool till the time money is received from MGC against these delinquent contracts).

As can be seen in the table above, there is some amount of regulatory Tier 1 capital release for the banks on account of MG cover on the underlying loans post securitisation.

Table 10: Impact of MG cover on Tier 1 capital requirement for Banks under Basel II framework post Securitisation

	Without MG cover	With 30 % MG (Top Cover)	With 30 % MG (Quota Share)
Principal amount securitised/ assigned	100	100	100
Credit enhancement stipulated[10]	10	5.5	7.5
Capital required by originator prior to securitisation	4.5	3.7	3.7
Capital required by originator post securitisation	4.5	2.8	3.4
Extent of regulatory capital release for originator on account of MG cover alone (prior to securitisation)		0.8	0.8
Extent of additional regulatory capital release for the originator on account of securitisation	0	0.9	0.3
Extent of total regulatory capital release on account of both MG cover and securitisation	0	1.7	1.1

Table 11: MG cover at contract level vis-a-vis credit enhancement for securitisation transaction

	MG Cover on the underlying portfolio loans	Credit enhancement as prevalent for a securitisation transaction (at pool level)
1	Loss borne by the MGC would be capped at a contract level (as per extent of guarantee cover mutually decided between the originator and MGC).	There is no cap on the loss that can be absorbed by the credit enhancement at a contract level (as long as there is credit enhancement available in the transaction.
2	MG cover on the underlying loans does not cover certain events like fraud committed by the originator, breach of certain reps and warranties by the originator etc.	Credit enhancement is unconditional and irrevocable. Any claim by the Trustee cannot be rejected as long as there is some amount of credit enhancement left unutilised.
3	Claim on MGC can be made by the originator only after an account has become NPA and thereafter (if the account remains uncured).	Claim can be made by the Trustee in case there is any shortfall in meeting promised payouts to the investor(s) in the securitisation/ DA transaction.

5.2 MGC directly providing credit enhancement for securitisation/ direct assignment

The terms of the securitisation transaction and the MG product would need to be structured such that the quality of the credit support being provided by the MGC is almost similar to that of credit enhancement in its present forms. Due to the nature of the product and stipulated guidelines it may not be possible to replace the current forms of credit enhancement with MG completely. However, in this section, for the purpose of illustration, we have taken an ideal situation where the MGC is able to replace the current forms of credit enhancement with all its intrinsic benefits.

The key differences between the regular MG product and the credit enhancement in a securitisation transaction are as seen in Table 11.

As mentioned earlier, the prevailing RBI guidelines on DA transactions do not permit any form of credit enhancement from the originator. Going forward, the MGC can provide credit enhancement (in the form of guarantee) for DA mortgage loan transactions. This is because the MGC is well-equipped to take a view on the underlying credit risk in these transactions. As per the rating agency ICRA, external credit enhancement from the MGC augurs well for DA transactions (involving mortgage loans) and can substantially revive interest in such transactions, provided the premium charged by the MGC makes economic sense for the originators.

In Securitisation transactions, credit enhancement is usually provided by the originator (funded upfront in the form of a fixed deposit), and not an independent third party. Even if the credit enhancement (either in part or in full) is available in the form of a bank guarantee (BG), the credit risk on the underlying pool of contracts is still being borne by the originator (as the bank providing the guarantee typically has a back-to-back counter-guarantee from the originator). Going forward, even for securitisation transactions, credit enhancement could be provided by the MGC.

The provision of credit enhancement securitization transactions by the MGC may need to be structured specifically for the Indian market, keeping in mind the regulatory framework. Credit enhancement from the MGC for securitisation transactions would provide the following benefits to the originator:

- Release of regulatory and economic capital - In the absence of any credit enhancement from the originator, the entire capital in rela-

[10] Assumed to be entirely First Loss Facility

tion to portion of the book assigned can get released

- No negative carry associated with cash collateral (which is generally the case when the credit enhancement provided by the originator is fully funded upfront)

6. Improvement in return on equity

Using the MG product could result in an improvement in ROE for the lender. The impact of a mortgage guarantee standalone and MG as credit enhancement for securitization transactions would be a function of:

- Capital relief
- Reduction in credit cost
- Guarantee fee

While capital relief would increase the leveraging capacity of the lender, it would have to pay an upfront guarantee fee to replace part of the core equity capital with the capital of the MGC. The guarantee fee being an upfront payment would have to be amortised over the tenure of the mortgage loan to assess the impact on the lender's ROE. Key assumptions for amortisation of the guarantee fee are enclosed as Appendix 3.

As shown in Chart 1, the ROE for an HFC improves with the MG cover and is also linked to the type of MG cover. The size and type of MG cover has a key bearing on capital relief; the higher the MG cover, the higher is the capital relief, and therefore, the larger is the improvement in the ROE. At the same time, economic capital relief is much higher for Top Cover than for Quota Share, which translates into a better return on equity.

Impact on the ROE of bank under the Basel II framework for securitisation transactions

While capital relief would increase the leveraging capacity of the lender, it would have to pay an upfront guarantee fee to replace part of the core equity capital with the capital of the mortgage guarantee company. The guarantee fee being an upfront payment, this would have to be amortised over the tenure of the mortgage loan to assess the impact on the lender's return on equity. Key assumptions for amortisation of guarantee fee are enclosed as Appendix 3.

Chart 1 Impact of mortgage guarantee on return on equity

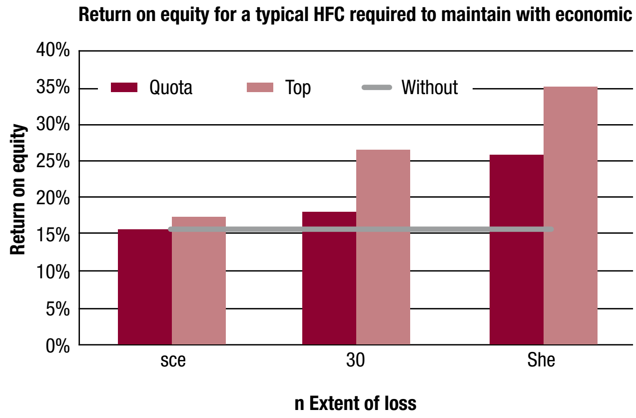
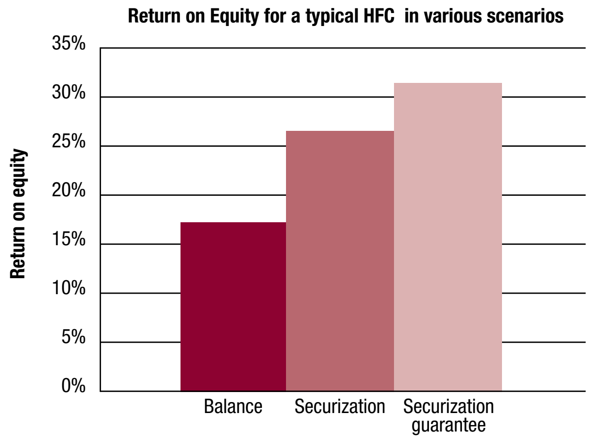


Chart 2 Impact of mortgage guarantee on return on equity



As Chart 2 shows, the return on equity for an HFC improves with securitization done with a mortgage guarantee.

Appendix 1: Essential features of a mortgage guarantee contract

The essential features of a MG contract, as per RBI guidelines applicable on MGC, are as follows:

- It shall be a contract of guarantee under Section 126 of the Indian Contract Act, 1872;
- The mortgage guarantee contract shall be unconditional and irrevocable and the guarantee obtained shall be free from coercion, undue influence, fraud, misrepresentation, and/or mistake under Indian Contract Act, 1872 ;
- It shall guarantee the repayment of the principal and interest outstanding in the housing loan account of the borrower, up to the amount of guarantee;
- The guarantor shall pay the guaranteed amount on invocation without any adjustment against the realisable value of the mortgage property;
- It shall be a tri-partite contract among the borrower, the creditor institution and the mortgage guarantee company, which provides the mortgage guarantee.

Appendix 2:

Possible reduction in Tier 1 regulatory capital requirement

Table 1: Tier 1 capital release for 50% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	3.00%	4.75%	4.00%
Capital requirement of the originator with MG	15%	2.82%	4.47%	3.76%
	30%	2.64%	4.18%	3.52%
	50%	2.40%	3.80%	3.20%
Regulatory Capital Release	15%	6%	6%	6%
	30%	12%	12%	12%
	50%	20%	20%	20%

Table 2: Tier 1 capital release for 75% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	4.50%	7.13%	6.00%
Capital requirement of the originator with MG	15%	4.10%	6.48%	5.46%
	30%	3.69%	5.84%	4.92%
	50%	3.15%	4.99%	4.20%
Regulatory Capital Release	15%	9%	9%	9%
	30%	18%	18%	18%
	50%	30%	30%	30%

Tier 1 capital release in case MGC is rated at AAA

Table 3: Tier 1 capital release for 50% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	3.00%	4.75%	4.00%
Capital requirement of the originator with MG	15%	2.73%	4.32%	3.64%
	30%	2.46%	3.90%	3.28%
	50%	2.10%	3.33%	2.80%
Regulatory capital release	15%	9%	9%	9%
	30%	18%	18%	18%
	50%	30%	30%	30%

Table 4: Tier 1 capital release for 75% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	4.50%	7.13%	6.00%
Capital requirement of the originator with MG	15%	4.01%	6.34%	5.34%
	30%	3.51%	5.56%	4.68%
	50%	2.85%	4.51%	3.80%
Regulatory capital release	15%	11%	11%	11%
	30%	22%	22%	22%
	50%	37%	37%	37%

Appendix 3: Key assumptions for amortization of guarantee fee

Year	Principal outstanding at the end of period	Fee amortization %	Cumulative fee % amortized
1	97%	22.0%	22.0%
2	80%	19.7%	41.7%
3	63%	15.9%	57.6%
4	49%	12.5%	70.2%
5	38%	9.8%	80.0%
6	29%	7.5%	87.5%
7	21%	5.5%	93.0%
8	15%	4.0%	97.0%
9	12%	3.0%	100.0%

Source: ICRA estimates, principal amortization based on actual amortization schedule of ICRA rated MBS transactions

Appendix 4: System level Tier 1 capital

Table 1: System level Tier 1 capital for 50% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	3.00%	4.75%	4.00%
System level capital with MG from AA rated MGC	15%	3.27%	4.92%	4.21%
	30%	3.54%	5.08%	4.42%
	50%	3.90%	5.30%	4.70%

Table 2: System level Tier 1 capital for 75% risk weight loans

	EXTENT OF MG COVER	BANKS		HFC
		Basel II	Basel III	
Capital requirement of the originator without MG	0%	4.50%	7.13%	6.00%
System level capital with MG from AA rated MGC	15%	4.77%	7.16%	6.14%
	30%	5.04%	7.19%	6.27%
	50%	5.40%	7.24%	6.45%